TAX UPDATE

For period: 1 July 2018 to 30 September 2018

Prepared by: Johan Kotze

TABLE OF CONTENTS

1. INTRODUCTION 5

2. MEDIA STATEMENT – PUBLICATION OF THE 2018 DRAFT TAXATION LAWS AMENDMENT BILL AND 2018 DRAFT TAX ADMINISTRATION LAWS ADMENDMENT BILL FOR COMMENT 6

3. EXPLANATORY MEMORANDUM ON THE TAXATION LAWS ADMENDMENT BILL, 2018 – 16 JULY 2018 9

3.1. Clarifying the tax treatment and oblifations of funds managed by bargaining councils 9
3.2. Addressing anomalies in respect of medical tax credits 12
3.3. Removing taxable benefit on to low or interest free loans granted to low-income employees for low-cost housing 14
3.4. Tax treatment of transfers of actuarial surplus between retirement funds 15
3.5. Alignment of tax treatment of withdrawals from preservation funds upon emigration or repatriation on expiry of work visa 17
3.6. Tax treatment of transfers to pension preservation or provident preservation funds after reaching normal retirement age but before retirement date 18
3.7. Refinement of rules dealing with conversion of debt in equity and artificial repayment of debt 19
3.8. Clarification of the interaction between the anti-avoidance rules dealing with dividend stripping and corporate re-orginsation rules 25
3.9. Introducing specific anti-dividend stipping rules regarding preference shares 31
3.10. Determination of an operating company for debt-financed acquisitions of controlling share interests 33
3.11. Closing of a loophole in debt relief rules 36
3.12. Addressing tax avoidance through the use of collateral arrangement provisions 39
3.13. Tax implications of fruitless and wasteful expenditure in respect of public entities 41
3.14. Allowing newly licenced South African exchanges to utilize the REIT provisions in the Act 42
3.15. Creating more certainty on the tax treatment of doubtful debts 44
3.16. Tax treatment of amounts received by or accrued to portfolios of collective investment schemes 46
3.17. Review of venture capital company rules 48
3.18. Extending the distribution period for small business funding entities 51

3.19. Review the write-off period for electronic communication cables 52
3.20. Review of international shipping rules 54
3.21. Extension of employment tax incentive scheme 56
3.22. Addressing an overlap in the treatment of dividend as defined in section 1 and amount deemed as dividend in section 31 57
3.23. Reversing exchange difference for exchange items disposed at a loss 59
3.24. Rules addressing the use of trust to defer tax or recharacterize the nature of income 60
3.25. VAT – Insertion of the definition of 'face value' under the provisions dealing with irrecoverable debts 63

4. MEMORANDUM ON THE OBJECT OF THE TAX ADMINISTRATION LAWS AMENDMENT BILL, 2018 64

4.1. Retirement fund approvals – Financial Sector Conduct Authority 64
4.2. Repeal requirement to submit a return if only tax-exempt dividend received 65
4.3. Directors of private companies – no longer subject to PAYE, fringe benefits 65
4.4. Automatically a provisional taxpayer 66
4.5. Capital gains for non-provisional taxpayer 66
4.6. Employer – 14 days before or after last day of February re. employee's tax 66
4.7. VAT – replaced tax invoices 67
4.8. VAT – Going concern, credit note in respect of goods return 68
4.9. VAT – Refund claims, prescription, 68
4.10. VAT – Branches, set-off and recovery provisions 68
4.11. VAT – Members of joint venture, jointly liable 69
4.12. Tax Administration – Notification of start of audit 69
4.13. Tax Administration – Understatement penalty 69

5. TAX CASES 70

5.1. C:SARS v Short and another 70
5.2. ITC 1906 – Deduction – Social Development Expenditure 74
5.3. ITC 1907 – Mining – Mining operations 81
5.4. ITC 1908 – Tax Administration – Understatement penalty 92
5.5. Arundel School v Zimbabwe Revenue Authority 97
5.6. ITC 1909 – Deduction, loss incurred for breach of contract 102
5.7. ITC 1910 – Tax avoidance 106
5.8. Lion Match Company (Pty) Ltd v C:SARS 113
5.9. C:SARS v Executers Estate Late Sidney Ellerine 116
5.10. Marshall No and others v C:SARS 123
5.11. ITC 1911 – Tax Administration 127
5.12. ITC 1912 – Tax Administration 132

6. INTERPRETATION NOTES 138

6.1. Section 24I – Gains or losses on foreign exchange transactions – No. 101 138

6.2. Classification of risk policy and the once-off election to transfer certain policies or classes of policies issued before 2016 to the risk policy fund – No. 102 — 142
6.3. Resident: Definition in relation to a natural person – physical presence test – No. 5 — 144
6.4. Deduction of security expenditure – No. 45 (Issue 3) — 145
6.5. The VAT treatment of supplies of international and ancillary transport services – No. 103 — 145

7. BINDING PRIVATE RULINGS — 147

7.1. BPR 306 – Donation to a special trust — 147
7.2. BPR 307 – Relief from double taxation of interest — 148
7.3. BPR 308 – Assumption of contingent liabilities and the cession of a right of recovery — 150
7.4. BPR 309 – Disposal of an asset by a public benefit organisation — 153
7.5. BPR 310 – Customer loyalty programme — 155

8. BINDING GENERAL RULINGS — 158

8.1. BGR 39 (Issue 2) – VAT treatment of municipal affected by changes to municipal boundaries — 158
8.2. BGR 48 – The temporary letting of dwellings by developers and the expiry of section 18B — 161

9. BINDING CLASS RULINGS — 164

9.1. BCR 64 – Transfer of a security that constitutes a participatory interest in a collective investment scheme — 164
9.2. BCR 65 – Post-retirement medical aid benefits — 166

10. INDEMNITY — 167

1. INTRODUCTION

The purpose of this update is to summarise developments that occurred during the third quarter of 2018, specifically in relation to Income Tax and VAT. Johan Kotze, a Tax Executive at Shepstone & Wylie Attorneys, has compiled this summary.

The aim of this summary is for readers to be exposed to the latest developments and to consider areas that may be applicable to their circumstances. Readers are invited to contact Johan Kotze to discuss their specific concerns and, for that matter, any other tax concerns.

Readers are especially advised to consider the Taxation Laws Amendment Bill.

Interpretation notes, rulings and guides are all important aspects of the developments that took place, as they give taxpayers an insight into SARS' application of specific provisions.

Enjoy reading on!

The tax advisor had just read the story of Cinderella to his four-year-old daughter for the first time. The little girl was fascinated by the story, especially the part where the pumpkin turns into a golden coach. Suddenly she piped up, "*Daddy, when the pumpkin turned into a golden coach, would that be classed as income or a long-term capital gain*?"

2. MEDIA STATEMENT – PUBLICATION OF THE 2018 DRAFT TAXATION LAWS AMENDMENT BILL AND 2018 DRAFT TAX ADMINISTRATION LAWS ADMENDMENT BILL FOR COMMENT

The National Treasury today publishes the draft Taxation Laws Amendment Bill, 2018 (TLAB) and draft Tax Administration Laws Amendment Bill, 2018 (TALAB). The TLAB and TALAB include the legislative amendments for the more complex tax proposals that were announced in the 2018 Budget Review on 21 February 2018.

These bills complement the draft Rates and Monetary Amounts and Amendment of Revenues Laws Bill (Rates Bill), which was published on Budget Day on 21 February 2018. They therefore exclude the tax proposals covered in the draft Rates Bill, which covered, *inter alia*, the changes to:

- the value-added tax rate;
- the personal income tax brackets;
- the medical tax credits;
- the rate of estate duty and donations tax; and
- excise duties.

Public consultations on the draft Rates Bill are currently in progress in Parliament, and Parliament will communicate the specific dates for the public consultations on the TLAB and TALAB, which is expected to be in August 2018. It should be noted that tax bills have a different parliamentary process to other bills, with consultations taking place on the draft bills, after which they will still be formally tabled in Parliament which is expected to be at the end of October 2018.

National Treasury and the SARS welcome written public comment on the tax proposals contained in the TLAB and the TALAB. After receipt of the comments, National Treasury and SARS will invite all those who provided inputs to attend

further workshops to discuss the issues raised in greater detail.

Parliament will also initiate its own hearings and consultations process after mid-August. National Treasury and SARS will thereafter publish a response document to provide formal written responses to the queries on the bills and will prepare revised versions of the TLAB and TALAB, which incorporate changes arising from these engagements. The current version of the bills, the response document and the revised bills will be presented to the Standing and Select Committees on Finance before they are tabled in Parliament.

The main tax proposals contained in the draft TLAB are:

- Providing more flexibility for the treatment of retirement fund transfers and withdrawals;
- Introducing a fringe benefit exemption for lower-income employees who receive a loan from their employer for low-cost housing;
- Reviewing the International Shipping exemption for purposes of accommodating the use of replacement ships;
- Shortening the write-off period for electronic communications cables;
- Refinements and clarification for the conversion of debt to equity;
- The refinement of the interaction between the anti-avoidance rules for dividend stripping with corporate re-organisation rules;
- Inserting rules addressing the use of trusts to defer tax or recharacterise the nature of income; and
- Introduction of a one year income characterisation rule for amounts accrued to portfolios of collective investment schemes to provide certainty and limit potential abuse.

The main tax administration proposals contained in the draft TALAB relate to:

- A removal of the requirement to submit tax returns for individuals receiving a tax-exempt dividend;
- Anti-forestalling amendments for excise duties;

- Clarifications on handling incorrect invoices for value-added tax refunds; and
- Allowing the collection of value-added tax payments to apply across branches and divisions.

Other issues arising from previous legislative commitments:

- Extension of the Employment Tax Incentive

  The draft TLAB contains a draft proposal to extend the Employment Tax Incentive for a further term of 5 years. This proposal is subject to further consultation and review. As part of the review of this programme, a round of consultations with social partners has been convened by the NEDLAC secretariat. In addition to the comments submitted on the TLAB, any parties interested in providing inputs into the review of the programme are requested to send an email to employment.incentive@treasury.gov.za.

- Annuitisation for provident fund members

  The draft TLAB does not contain amendments related to annuitisation for provident fund members. The legislation that is currently in effect states that from 1 March 2019 provident fund members may be required to purchase an annuity from contributions made to their provident fund after 1 March 2019. Provident fund members who are over the age of 55 on 1 March 2019 or who make additional contributions to their provident fund after 1 March 2019 that do not exceed R247 500 at the time of their retirement will not be affected in any way. The process of consultation within NEDLAC is taking longer than anticipated following the release of the paper on comprehensive social security on 25 November 2016. Government may introduce further legislative amendments related to the start-date of 1 March 2019 once the NEDLAC process is completed or provides any recommendation, expected to be no later than end-October. In the meantime, comments related to this tax deduction can be submitted to National Treasury at piwe.tshombe@treasury.gov.za.

- Review panel for VAT zero-rated items

In addition to the above, it should be noted that the amendments to these bills or the Rates Bill may also be effected before October, to take into account any recommendations made from by the Davis Tax Committee's panel reviewing the current list of VAT zero-rated items. The independent panel was established on 29 March 2018 and has received public submissions and held hearings and is preparing a report to provide to the Minister of Finance by the end of July 2018.

3. EXPLANATORY MEMORANDUM ON THE TAXATION LAWS ADMENDMENT BILL, 2018 – 16 JULY 2018

3.1. Clarifying the tax treatment and oblifations of funds managed by bargaining councils

[Applicable provisions: New paragraphs 2(*m*) and 12E of the Seventh Schedule to the Income Tax Act]

BACKGROUND

In 2017, changes were made in the Taxation Laws Amendment Act No.17 of 2017 (2017 TLAA) in order to afford Bargaining Councils established in terms of section 27 of the Labour Relations Act No. 66 of 1995 an opportunity to regularise their tax affairs to become tax compliant with the provisions of the Act.

The relief, formally referred to as 'Bargaining Council tax relief' in Part II of the 2017 TLAA covers non-compliant Bargaining Councils in respect of employees' tax that should have been deducted from all payments made by the Bargaining Councils to their members between 1 March 2012 and 28 February 2017 and income tax that should have been paid in respect of all undeclared amounts (growth/returns) received by or accrued to the Bargaining Councils between 1 March 2012 and 28 February 2017.

However, going forward, Bargaining Councils are expected to be fully tax compliant and will not be afforded any legislative relief.

REASONS FOR CHANGE

In line with Government's policy to encourage taxpayer compliance with prevailing tax law as well as Government's policy of a tax system that fosters ease of compliance with tax legislation, Government held public consultations with various Bargaining Councils to discuss the way forward regarding tax compliance of Bargaining Councils.

As a result, general consensus emerged during the public consultations that going forward, i.e. post the Bargaining Council tax relief, compliance with prevailing tax legislation in respect of employees' tax that should be deducted from all payments made by the Bargaining Councils to their members can be accommodated through the application of withholding taxes, such as Pay-As-You-Earn (PAYE) by the employer in respect of contributions made in respect of employees who are members of a Bargaining Council to the funds administered by the Bargaining Councils. This consensus was reached based on the understanding that the employer withholding can be operated by virtue of the tried and tested administrative architecture already in place for PAYE withholding.

A. PAYE withholding by the employer in respect of employer contributions made in respect of employees to funds managed by the Bargaining Council

Employer contributions to funds administered by Bargaining Councils for the benefit of employees should constitute a taxable fringe benefit in the employee's hands and be subject to PAYE withheld by employers. The value of the taxable fringe benefit should be the contribution made by the employer on behalf of the employee. In the event that bulk contributions are made by the employer on behalf of employees to the funds administered by the Bargaining Councils and the employer is unable to attribute specific contributions to specific employees, the taxable fringe benefit is to be calculated in respect of the total contributions paid by the employer divided by the number of employees on behalf of which the contributions are paid. The above taxable fringe benefit provisions should not be applicable to the extent that the contribution is being made to a pension or provident fund as the taxation of those contributions is already specifically catered for in the

Act.

In cases where the employee makes contributions to the fund administered by the Bargaining Council, they should not be subject to PAYE withholding by the employer as the contributions can only be made from the employee's post-tax income.

Based on the above, as both employer and employee contributions to the funds administered by the Bargaining Councils would have been subjected to PAYE withholding, any payments made by the funds administered by the Bargaining Councils to their members should be tax free, except to the extent that the pay-out is from a pension or provident fund.

B. *Income tax payable by the Bargaining Council in respect of amounts received by or accrued to that Bargaining Council*

Except for Bargaining Councils qualifying for Bargaining Council tax relief, or that did get an official confirmation of income tax exemption from SARS, income tax is payable in respect of all amounts (in the form of growth and/returns) received by or accrued to them.

PROPOSAL

In view of the above, it is proposed that the following amendments be made in the Act to regularise the tax treatment of funds managed by Bargaining Councils:

A. *PAYE withholding by the employer in respect of employer contributions made in respect of employees to funds managed by the Bargaining Council*

The employer should be required in terms of the Fourth Schedule to the Act to withhold PAYE from employer contributions to the funds administered by the Bargaining Councils in respect of employees who are members of those Bargaining Councils. The above fringe benefit provisions will not be applicable to the extent that the contribution is being made to a pension or provident fund as the taxation of the above mentioned contributions is already specifically catered for in the Act.

Employee contributions to the fund administered by the Bargaining Council

will not be subject to PAYE withholding as such contributions can only be made from after taxed income.

As both employer and employee contributions to the funds administered by the Bargaining Councils would have been subjected to PAYE withholding, any payments made by the funds administered by the Bargaining Councils to their members should be tax free, except to the extent that the pay-out is from a pension or provident fund.

B. Income tax payable by the Bargaining Council in respect of amounts received by or accrued to that Bargaining Council

Under current law, Bargaining Councils that did not get an official confirmation of income tax exemption from SARS should pay income tax to SARS in respect of amounts received by or accrued to those Bargaining Councils. 6

EFFECTIVE DATE

The proposed amendments will come into operation on 1 March 2019 and apply in respect of any year of assessment commencing on or after that date.

3.2. Addressing anomalies in respect of medical tax credits

[Applicable provision: Section 6A of the Act]

BACKGROUND

In 2011, the system of deductions against income in respect of medical scheme contributions paid by individual taxpayers for the benefit of themselves, their spouse and dependents was converted to a medical tax credit system. Medical tax credits are non-refundable and they operate in a similar manner as the normal tax rebates which are used to reduce a taxpayer's normal tax liability.

Section 6A of the Act makes provision for a prescribed amount of monthly medical scheme contributions that will qualify as a medical tax credit, which gradually increases depending on the number of dependants covered under a medical

scheme plan.

REASONS FOR CHANGE

There are instances where medical scheme contributions are being proportionally shared by taxpayers, for example, children jointly contributing towards their parent's medical expenses under a medical scheme or under more than one medical scheme. Although medical scheme contributions are being proportionally shared, there is an unintended anomaly in the provisions of the Act that currently allows each of the taxpayers who proportionally share the medical costs for a single individual (for example, their mother) to independently claim the full medical tax credit for each of the shared dependants (their mother).

As a result, upon assessment, taxpayers who have opted to share the cost of medical scheme contributions are being allowed the full medical tax credit in respect of a dependant. Due to the fact that the medical scheme contributions are being shared, medical tax credits should be apportioned between the various taxpayers who are contributors to the medical scheme in respect of a dependent.

PROPOSAL

In order to address this anomaly, it is proposed that amendments be made to the Act so that, where taxpayers carry a share of the medical scheme contributions in respect of dependants, medical tax credits should be proportionally allocated between taxpayers who made the payment of medical scheme contributions.

Further, it is proposed that consequential amendments should be made to the definition of 'dependant' in section 6A to cater for instances where the person making the medical scheme contributions and the person the payments are made on behalf of, are not in the same medical scheme, as required in terms of the Medical Schemes Act. As a result, the definition of 'dependant' in section 6A will be aligned with the definition of 'dependant' in section 6B.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 March 2018 and apply in respect of years of assessment commencing on or after that date. 7

3.3. *Removing taxable benefit on to low or interest free loans granted to low-income employees for low-cost housing*

[Applicable provision: Paragraph 11(4) of the Seventh Schedule to the Act]

BACKGROUND

Paragraph 2 of the Seventh Schedule to the Act makes provision for a taxable benefit deemed to have been granted by the employer if, by reason of such employment, the employee is granted one of the benefits described in that paragraph. This includes, inter alia, the acquisition of an asset (for example a house) at less than actual market value or the provision of low or interest free loans.

In order to encourage employers that empower their low-income earning employees through home ownership, amendments were made in 2014 to paragraph 5(3A) of the Seventh Schedule to the Act to remove the taxable benefit in respect of employer provided housing for the benefit of low-income earning employees, provided that such employees' remuneration proxy does not exceed R250 000 per annum and the low-cost housing has a market value not exceeding R450 000.

REASONS FOR CHANGE

The above-mentioned 2014 amendments regarding the relief from triggering a taxable benefit do not apply in instances where a low-income earning employee requires a loan directly from the employer to fund the acquisition of low cost housing.

Consequently, if an employer provides a low or interest free loan for the acquisition of a low-cost house instead of solely providing low-cost housing to a low-income earning employee, the low or interest free loan will, in terms of paragraph 11 of the Seventh Schedule of the Act, be regarded as a taxable benefit in the hands of that employee.

In line with Government's policy to promote the provision of housing, it is the objective of Government to be supportive of employers who take this initiative

aimed at benefiting low-income earning employees. Consequently, whether an employer provides low-cost housing or a low or interest free loan for the acquisition of low-cost housing to a low-income earning employee, the tax treatment should be the same, provided that the ultimate ownership of the residential accommodation belongs to the employee.

PROPOSAL

In order to accelerate the Government's policy of providing housing, it is proposed that the relief from triggering a taxable benefit be extended to apply to a low or interest free loan with a value not exceeding R450 000 provided by an employer to a low-income earning employee with a remuneration proxy not exceeding R250 000, provided the loan is granted solely for the acquisition of residential accommodation.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 March 2019 and will apply in respect of years of assessment commencing on or after that date. 8

3.4. Tax treatment of transfers of actuarial surplus between retirement funds

[Applicable provisions: Paragraphs 1, 2(*l*) and 4 of the Seventh Schedule to the Act]

BACKGROUND

Currently, paragraph 2(*l*) of the Seventh Schedule to the Act provides for a taxable benefit to have been granted by an employer to an employee in cases where an employer makes any contributions to a retirement fund for the benefit of an employee. Further, paragraph 4 of the Seventh Schedule to the Act makes provision for any benefit provided to an employee by an associated institution of the employer to create a taxable benefit in the employee's hands if such benefit would have constituted a taxable benefit had it been granted directly by the employer. Such benefit is deemed to have been granted by the employer.

Associated institutions, as defined in paragraph 1 of the Seventh Schedule include, *inter alia*, any fund established solely or mainly for providing benefits for employees or former employees of an employer.

REASONS FOR CHANGE

Based on the above-mentioned provisions of Seventh Schedule to the Act, any contributions made by an employer owned retirement fund into another employer owned retirement fund for the benefit of the employees shall create a taxable fringe benefit in the hands of employees.

This tax treatment would also apply in respect of transfers of actuarial surpluses between, or within retirement funds of the same employer. The transfer is deemed to be a contribution by the fund for the benefit of employees, and is as a result of the application of the provisions of the Seventh Schedule to the Act regarded as a taxable benefit in the employee's hands.

In principle, Government is of the view that there should be no additional tax consequences for members of the fund if the transfers between, or within retirements funds of the same employer refer to amounts that have already been contributed to a retirement fund.

PROPOSAL

In order to address these unintended anomalies, it is proposed that amendments be made to the Act to allow for transfers of amounts as contemplated in section 15E(1)(*b*) of the Pension Funds Act No 24 of 1956 between, or within retirements funds of the same employer not to create a taxable fringe benefit in the employee's hands.

EFFECTIVE DATE

The proposed amendments are deemed to have come into operation on 1 March 2017 and apply in respect of years of assessment commencing on or after that date.

3.5. *Alignment of tax treatment of withdrawals from preservation funds upon emigration or repatriation on expiry of work visa*

[Applicable provisions: Section 1 of the Act, the definition of 'Pension Preservation Fund', definition of 'Provident Preservation Fund']

BACKGROUND

Paragraph (*b*)(x)(*dd*) of the proviso to the definition of 'retirement annuity fund' in section 1(1) of the Act makes provision for a payment of lump sum benefits where a member of a retirement annuity fund ceases to be a tax resident, withdraws from the retirement annuity fund due to that member emigrating from South Africa and such emigration is recognised by the South African Reserve Bank for the purposes of exchange control.

The above-mentioned definition of 'retirement annuity fund' also allows for expatriates to withdraw a lump sum from their retirement annuity when they leave South Africa at the expiry of the work visa that was granted in terms of the Immigration Act No. 13 of 2002.

REASONS FOR CHANGE

The current provisions of the Act only allow members of retirement annuity fund to be able to access and withdraw the full value of their post-tax retirement benefits upon emigration or repatriation on expiry of the work visa, while members belonging to a pension preservation fund or a provident preservation fund are restricted from doing so.

As a result, when members of pension preservation or provident preservation funds emigrate from South Africa and such emigration is recognised by the South African Reserve Bank for the purposes of exchange control or upon repatriation on expiry of the work visas, they are not entitled to receive a lump sum payment from their pension preservation or provident preservation funds.

PROPOSAL

In order to promote Government's policy of a uniform approach on the tax treatment of all retirement funds, it is proposed that the tax treatment of different

types of preservation fund withdrawals be aligned to allow members of all preservation funds to be able to access and withdraw the full value of their post-tax retirement benefits upon emigration or repatriation on expiry of the work visas.

Consequently, it is proposed that the definitions of 'pension preservation fund' and 'provident preservation fund' in section 1 of the Act be amended to make provision for the members of pension preservation funds and provident preservation funds to be entitled to withdraw their full lump sum benefit when they emigrate from South Africa and such emigration is recognised by the South African Reserve Bank for the purposes of exchange control or upon repatriation on expiry of the work visas.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 March 2019 and apply in respect of years of assessment commencing on or after that date. 10

3.6. Tax treatment of transfers to pension preservation or provident preservation funds after reaching normal retirement age but before retirement date

[Applicable provisions: Section 1 of the Act, definition of 'Pension Preservation Fund'; definition of 'Provident Preservation Fund'; definition of 'Pension Fund'; definition of 'Provident Fund', paragraph 6A of the Second Schedule to the Act]

BACKGROUND

In 2017, amendments were made in the Act to allow employees to transfer their benefits from a pension or provident fund into a retirement annuity fund on or after reaching normal retirement age, as defined in the rules of the fund, but before retirement date. These amendments increased the choice of available retirement funds in cases where individuals decided to postpone retirement.

REASONS FOR CHANGE

Currently, the Act only allows transfers from a pension or provident fund to a retirement annuity fund after reaching normal retirement age but before an election

to retire is made by the member of the fund. Transfers to pension preservation and provident preservation funds are excluded as it was considered that it would be administratively burdensome, as it could result in the withdrawal of all benefits as a lump sum, rather than the preservation of funds, as restricting that withdrawal could result in further complexity. During public consultations on the 2017 Draft Taxation Laws Amendment Bill (2017 Draft TLAB), industry indicated that the system changes required for the transfers to pension preservation and provident preservation fund will not be onerous.

PROPOSAL

In order to address these concerns, it is proposed that changes be made in the Act to allow for transfers from a pension or provident fund to a pension preservation or provident preservation fund on or after reaching normal retirement age, as defined in the rules of the fund, but before retirement date. In addition, the single allowable withdrawal applicable to preservation funds will not apply to the amounts transferred from a pension or provident fund to a pension preservation or provident preservation fund made by the member of the fund after reaching normal retirement age but before an election to retire.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 March 2019 and apply in respect of years of assessment commencing on or after that date.

3.7. Refinement of rules dealing with conversion of debt in equity and artificial repayment of debt

[Applicable provisions: Section 19 of the Act and paragraph 12A of the Eighth Schedule to the Act]

BACKGROUND

The Act contains debt relief rules that make provision for tax consequences in respect of a waiver, cancellation, reduction or discharge of a debt owed by a taxpayer. Section 19 of the Act deals with income tax implications in respect of a

debt that was previously used to fund tax deductible expenditure such as operating expenses. On the other hand, paragraph 12A of the Eighth Schedule deals with capital gains tax implications in respect of a debt that was used to fund capital or allowance assets.

In 2017, various changes were made in the debt relief rules including the introduction of definitive rules dealing with the tax treatment of conversion of debt into equity and to ensure that these rules apply in all instances where a debt is settled by a debtor and the creditor received inadequate consideration for the debt claim. In particular, the above-mentioned 2017 changes include the following:

A. Introduction of definitions of 'Debt benefit' and 'Concession or Compromise' in debt relief rules

The definition of the term *'reduction amount'* was removed from section 19 and paragraph 12A of the Act. In turn, the following definition of the terms 'debt benefit' and 'concession or compromise' were introduced in the Act. These new definitions listed all events that would trigger a tax consequence under debt relief rules in terms of section 19 and paragraph 12A of the Act.

Under this new paradigm, the debt relief rules would be triggered when:

(a) A change in the terms or conditions of a debt or the substitution of a debt occurs;

(b) An obligation in respect of a debt is substituted for another obligation; and

(c) A debt is converted into shares.

In order to determine a 'debt benefit' in respect of which tax consequences would arise, a debtor would be required to determine the amount by which the face value of the claim held by the creditor in respect of that debt prior to entering into any of the above mentioned arrangements, exceeds the market value of the claim in respect of that debt or shares (as the case may be) held or acquired by reason or as a result of the implementation of these arrangements.

It came to government's attention that in some instances when a debt is settled by way of a debt to share conversion, it can result in an increase in the market value of the shares in another company held by the creditor that forms part of the same group of companies as the debtor, for example where the creditor also holds shares in a shareholder company of the debtor. In order to cater for the above mentioned scenario, amendments were made in the Act to make provision for the debt benefit determined to be reduced by any increase in the market value of the shares held by a creditor in another company that forms part of the same group of companies as the debtor company, provided that the increase is attributable solely to the implementation of the conversion of debt into equity.

B. *Exclusion of interest from the application of debt relief rules*

The 2017 changes made provision for the amounts of interest to be excluded from the application of the debt relief rules. As a result, amendments were made to the definition of debt to wholly exclude interest.

C. *Exclusion of debt to equity conversions limited to group companies*

Lastly, the 2017 changes proposed that the exclusion of debt to equity conversions should be limited to apply only between companies that form part of the same group of companies as contemplated in section 41 of the Act.

REASONS FOR CHANGE

Following the 2017 amendments to the debt relief rules, the following concerns regarding the practical application of the debt relief rules were raised:

A. *Changes to the terms and conditions*

Although there is an understanding that voluntary intra-group debt subordinations may be used for tax structuring, however, the inclusion of any changes in the terms or conditions of a debt as a '*concession or compromise*' may have the unintended consequence of affecting legitimate transactions. This is due to the fact that in instances when debt funding is

raised with third parties such as banks; it is often required by the lender (bank) that related party debt should be subordinated. As such, it is argued that the inclusion of a change in the terms and conditions of a debt as a '*concession or compromise*' is more of a blunt instrument aimed at targeting a narrow group of taxpayers and as a result, it should be removed.

B. *Substitution of debt*

The inclusion of a substitution of an obligation in respect of a debt adversely affects arrangements that do not result in any loss to the fiscus and as a result, it should be removed. Such arrangements include instances where a bridge loan (i.e. a temporary loan raised while waiting for the finalisation of permanent funding) is replaced by permanent funding.

C. *Quantification of a debt benefit based on the face value of a debt and its subsequent market value*

It is argued that determining the amount of a *'debt benefit'* by comparing the face value of a debt prior to a *'concession or compromise'* with the market value thereafter is cumbersome for each and every event and as a result, it should be removed.

PROPOSAL

In order to address the above mentioned issues, the following amendments are proposed in section 19 and paragraph 12A of the Act:

A. *Definition of a 'concession or compromise'*

A new and more comprehensive definition of a '*concession or compromise*' is proposed. Under this revised definition, circumstances under which the debt relief rules will apply will be limited to realisation events. In terms of the new definition, there will be no regard to changes in the terms and conditions of taxpayers' debt arrangements unless they result in a realisation event.

Furthermore, there will be a focus on interest-bearing debt in the case of debt to equity conversions so as to exclude equity loans that are

generally non-interest bearing. Group debt which is interest-bearing that is converted to equity will still be excluded from the application of the debt relief rules.

As a result, it is proposed that the following events should constitute a '*concession or compromise*':

(a) The cancellation, waiver or remittance of a debt;

(b) When a debt is extinguished by way of a redemption of the debt claim or by way of a merger by reason of the acquisition of the debt claim by the person owing that debt; and

(c) When an interest-bearing debt owed by a company to a person is settled by way of a conversion or exchange for shares in that company or by applying the proceeds from shares issued by that company to a person in the instance that immediately after this arrangement, the company is a connected person in relation to that person.

B. Definition of an 'interest-bearing debt'

In order to exclude equity loans from the ambit of the debt relief rules, it is proposed that only interest-bearing debt that is converted into to equity should be subject to the debt relief rules. In order to facilitate this exclusion of equity loans, it is proposed that a definition of what constitutes an '*interest-bearing debt*' for purposes of the debt relief rules should be introduced in section 19 and paragraph 12A of the Eighth Schedule to the Act. Under this definition, an '*interest bearing debt*' will be regarded as a debt in respect of which any interest (as defined in section 24J) has been or will be incurred; or any debt (whether interest-bearing or not) that directly or indirectly substitutes such a debt.

C. Definition of a 'debt benefit'

It is proposed that a 'debt benefit' should be determined in respect of a debt owed by a person to another person, as follows:

(a) In the case of a debt that is cancelled, waived or remitted, the debt benefit will be the amount that is cancelled, waived or remitted.

(b) In the case of a redemption of a debt claim or merger by reason of the debtor acquiring the claim in respect of the debt, the debt benefit will be the amount by which the face value of the claim exceeds the market value of the debt after such redemption or merger.

(c) In the case of debt to equity conversion where the creditor or another person that subscribes for or acquires shares in a company did not a direct or indirect interest in that company prior to the conversion, the debt benefit will be the amount by which the face value of the claim prior to the conversion exceeds the market value of the shares held or acquired by reason of or as a result of that conversion.

(d) In the case of a debt to equity conversion where the creditor or another company that subscribes for or acquires shares in a company held a direct or indirect interest in that company prior to the conversion, the debt benefit will be the amount by which the face value of the claim prior to the conversion exceeds the amount by which the market value of the shares held by the creditor or that other company after the conversion exceeds the market value of the shares held by that person in that company prior to that conversion.

D. Reductions to a 'debt benefit' determined in respect of debt converted into equity

A mechanism will also be included in respect of debt that is converted into shares to ensure that an increase in the value of the effective shareholding of the creditor in the debtor company is applied to reduce the debt benefit. This is a departure from the current mechanism as it results in a loophole that allows taxpayers to reduce their debt benefit by multiple increases of multiple layers of shareholdings in the debtor company (i.e. double counting due to direct and indirect shareholdings in the debtor company). As a result, definitions of a '*direct interest*' and an '*indirect interest*' will be inserted into

the section in order to clarify the operation of this mechanism to eliminate double counting.

E. Introduction of a definition of 'market value'

A definition of *'market value'* will also be introduced under the debt relief rules. The purpose of the introduction of this definition in this regard is to provide clarity of the timing of the determination of the market value of shares acquired in respect of a debt to share conversion. As a result, taxpayers will be required to determine the market value of shares acquired as a result of such arrangements, immediately after the implementation of the debt to share arrangement.

EFFECTIVE DATE

The proposed amendments will be deemed to have come into operation on 1 January 2018 and apply in respect of years of assessment commencing on or after that date.

3.8. Clarification of the interaction between the anti-avoidance rules dealing with dividend stripping and corporate re-orginsation rules

[Applicable provisions: Section 22B of the Act and paragraph 43A of the Eighth Schedule to the Act]

BACKGROUND

The anti-avoidance rules dealing with dividend stripping were first introduced in the Act in 2009. These rules were inserted to curb the use of dividend stripping structures by taxpayers as a result of the dividends tax exemption in respect of dividends paid by a resident company to another resident company. Dividend stripping normally occurs when a resident shareholder company that is a prospective seller of shares in a target company avoids income tax (including capital gains tax) arising on the sale of shares by ensuring that the target company declares a large dividend to that resident shareholder company prior to the sale of

shares in that target company to a prospective purchaser. This pre-sale dividend, which is exempt from Dividends Tax, decreases the value of shares in the target company. As a result, the seller can sell the shares at a lower amount, thereby avoiding a larger capital gains tax charge in respect of sale of shares.

In 2017, amendments were made in the Act in order to strengthen the anti-avoidance rules dealing with dividend stripping. According to the 2017 changes, exempt dividends that are regarded as extra-ordinary dividends, received by a shareholder resident company are treated as proceeds or income subject to tax for that resident shareholder company, provided that the shares in respect of which extra-ordinary dividends are received, are disposed of within a period of 18 months prior to that disposal. To ensure that resident companies do not avoid the application of these anti-avoidance rules by disposing of their shares using the roll-over provisions of the corporate re-organisation rules, amendments were made in the Act to make provision for the re-organisation rules to be subject to these anti-avoidance rules dealing with dividend stripping.

REASONS FOR CHANGE

It has come to Government's attention that the 2017 amendments making provision for the anti-avoidance rules dealing with dividend stripping rules to override cooperate re-organisation rules may affect some legitimate transactions. In particular, in instances where a resident company enters into a corporate re-organisation transaction and does not enter into any avoidance transaction thereafter (i.e. disinvesting from a company in respect of which a large dividend was previously received by or accrued to that resident company), the anti-avoidance rules dealing with dividend stripping should not nullify the roll-over relief provided under the corporate re-organisation rules.

PROPOSAL

In order to address these concerns, it is proposed that the following amendments be made in the Act to clarify the interaction between the anti-avoidance rules dealing with dividend stripping and the corporate re-organisation rules:

A. Reversal of the override of the corporate re-organisation rules

In order to ensure that the anti-avoidance rules dealing with dividend stripping rules do not affect legitimate transactions, it is proposed that the 2017 changes making provision for the anti-avoidance rules dealing with dividend stripping rules to override cooperate re-ogarnisation rules should be reversed. Instead, it is proposed that anti-avoidance rules dealing with dividend stripping rules should be triggered when the corporate re-organisation rules are abused by taxpayers who use the corporate re-organisation rules with the intention of subsequently disposing of their shares to unrelated purchasers outside of the realm of the re-organisation rules.

B. Introduction of the definition of the term 'deferral transaction'

It is proposed that amendments be made in the Act to clarify the timing of the trigger of the anti-avoidance rules dealing with dividend stripping and the tax consequence thereof in instances where corporate re-organisation rules are used by the taxpayers with the intention of subsequently disposing of their shares to unrelated purchasers outside of the realm of the re-organisation rules. As a starting point, it is it is proposed that a new definition of the term '*deferral transaction*' should be introduced under the anti-avoidance rules dealing with dividend stripping. The term *'deferral transaction'* should be defined to mean transactions in respect of which PART III of Chapter II of the Act (i.e. the corporate re-organisation provisions) apply.

C. Application of the anti-avoidance rules dealing with dividend stripping to disposals of shares that are not in terms of a deferral transaction

It is proposed that the anti-avoidance rules dealing with dividend stripping should also be triggered upon the disposal of shares by a resident company provided that that the disposal is not in terms of deferral transactions and a resident company received an extraordinary dividend within 18 months of the date of that disposal or as consequence of that disposal. As a result, where a resident company disposes of shares in another company as contemplated in the anti-avoidance rules dealing with dividend stripping, the

resident company will have to recognise as income or proceeds from the disposal of those shares (as the case may be) the amount of its extraordinary dividend in the year of assessment of that disposal. However, if the dividend that qualifies as an extraordinary dividend is received by or accrues to the resident company in a subsequent year of assessment, such amount must be taken into account when determining the tax liability of the resident company in that subsequent year of assessment. 16

D. Application of the anti-avoidance rules dealing with dividend stripping to disposals of shares in terms of a deferral transaction

Where a resident company disposes of shares it holds in another company in terms of a deferral transaction, the anti-avoidance rules dealing with dividend stripping rules will not be immediately triggered. However, it is proposed that specific claw-back rules should apply to exempt dividends received or accrued in respect of those shares or other shares acquired in exchange for those shares in respect of which such exempt dividends were received or accrued within 18 months of their acquisition. These claw back rules should apply at the time when such shares are subsequently disposed of in terms of a transaction that is not a deferral transaction within 18 months of their acquisition.

Application of the claw back rules: scenario 1

Where exempt dividends are received or accrued to the resident company 18 months prior to disposing of the shares in respect of which those exempt dividends were received or accrued in terms of a deferral transaction, in the case of a company that acquired the shares in respect of which those exempt dividends were received or accrued to another company in terms of that deferral transaction, the following should apply:

- If that company disposes of the shares so acquired within 18 months of the deferral transaction, that company is, for purposes of determining whether the anti-avoidance rules dealing with dividend striping apply to that subsequent disposal outside of a deferral transaction, deemed to have received or accrued the exempt

dividends that were previously received by or accrued to the company from the shares acquired in the period that that company held those shares. This is subject to an addition condition that the company and the company that previously received exempt dividends in respect of those shares are connected persons immediately after the deferral transaction. This is due to the fact that it is usually the result of deferral transactions.

Application of the claw back rules: scenario 2

Where exempt dividends are received or accrued to the resident company 18 months prior to disposing of the shares in respect of which those exempt dividends were received or accrued in terms of a deferral transaction, in the case a company that acquires other shares (herein after referred to as new shares) in exchange for or by virtue of holding shares disposed of in terms of a deferral transaction, the following should apply:

- If that company disposes of the new shares within 18 months of the deferral transaction, the company is, for purposes of determining whether the anti-avoidance rules dealing with dividend striping apply to that subsequent disposal outside of a deferral transaction, deemed to have received or accrued the exempt dividends that were previously received by or accrued to that company for shares it previously disposed of under the deferral transaction.

E. Application of anti-avoidance rules dealing with dividend stripping to exempt dividend splitting using deferral transactions

It is noted that taxpayers that are connected persons or that form part of the same group of companies may use deferral transactions to split exempt dividends among themselves in order to ensure that no one connected person or a group company receives an extraordinary dividend. As a result, it is proposed that the anti-avoidance rules dealing with dividend stripping should apply where:

(a) A company disposes of shares in terms of a transaction that is not a

deferral transaction and those shares were acquired in terms of a deferral transaction; and

(b) Within 18 months prior to the acquisition of those shares that are disposed of in terms of a transaction that is not a deferral transaction, exempt dividends were received by or accrued to another person who disposed of those shares in terms of a deferral transaction, and that person was a connected person in relation to that company during 18 months prior to the acquisition of those shares or that person was a connected person immediately after that disposal.

Under the above-mentioned circumstances, the exempt dividends of those connected persons will be treated as being those of the company that disposes of the shares within 18 months of acquiring them in terms of a deferral transaction.

F. Application of anti-avoidance rules dealing with dividend stripping to distributions derived from extraordinary dividends

Taxpayers may strip the value of a company after entering into a deferral transaction and avoid the application of the extraordinary dividend threshold by using a company with high value shares to on distribute exempt dividend.

In order to curb this abuse, it is proposed that amendments be made to the Act to ensure that taxpayers that embark on this kind of structuring are subject to the anti-avoidance rules dealing with dividend-stripping on the higher of:

(a) The extraordinary dividend determined from the application of the ordinary rule relating to disposal of shares within 18 months of a deferral transaction (set out in above) which under this example will be minimised due to the use of a high market value entity; or

(b) In the case of an exempt dividend received by a company in respect of the new shares that was derived, directly or indirectly, from an

amount that accrued to or was received as an exempt dividend in respect of the old shares by the company to which the old shares were disposed to within 18 months of that disposal, the extent to which the exempt dividend in respect of the old shares that funded the exempt dividend in respect of the new shares would have constituted an extraordinary dividend in respect of the old shares had those shares been disposed of in terms of a transaction that is not a deferral transaction.

This rule will, in the above example, ensure that the amount of the exempt dividend that High Value Co distributed to Company A be subjected, at the very least, to the dividend stripping rules to the extent that the dividend in respect of the old shares that funded it would have constituted an extraordinary dividend in respect of the old shares.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 January 2019 and apply in respect of any disposal on or after that date.

3.9. Introducing specific anti-dividend stipping rules regarding preference shares

[Applicable provisions: section 22B and paragraph 43A of the Eighth Schedule]

BACKGROUND

In 2017, the anti-avoidance rules dealing with dividend stripping were amended. These amendments related to the broadening of the current rules regarding anti-dividend stripping to, *inter alia*, take into account variations in the share buy-back and dividend stripping schemes that taxpayers were entering into in order to avoid normal tax on income or capital gains that would ordinarily arise on the outright sale of shares. In particular, the 2017 changes sought to expand on the limited scope of application of the then anti-dividend stripping rules.

In order to achieve this, the shareholding levels of a shareholder affected by the

rules were lowered for purposes of the application of the rules. The rules were amended to make pre-sale exempt dividends taxable in respect of any shares disposed of by a shareholder company that together with connected persons holds at least 50% of the shares in an unlisted company or holds at least 20% of the shares in an unlisted company in the instance that no other shareholder holds a majority interest in that unlisted company. In the case of listed companies, the rules would taint pre-sale exempt dividends in the instance that a shareholder company (together with connected persons) holds at least 10% of the shares in a listed company.

In addition, not all pre-sale exempt dividends are tainted by the rules as only those dividends that accrued to an affected shareholder that constitute extraordinary dividends will be taxable. In the case of preference shares, extraordinary dividends are the amount of pre-sale dividends received by or accrued to a shareholder company that exceeds the amount of dividends that would have been determined with reference to a rate of interest of 15%. For any other shares, extraordinary dividends are the amount of pre-sale dividends received by or accrued to a shareholder company within a period of 18 months prior to the disposal of shares or in respect or as consequences of the disposal of shares by that shareholder company in respect of which those shares exceed 15% of the higher of market value of those disposed shares 18 months prior to their disposal or at the date of their disposal.

REASONS FOR CHANGE

Subsequent to the 2017 changes, taxpayers have raised concerns that the rules around preference shares are vague and therefore need to be clarified. As a starting point, clarity in the form of a definition in the legislation of what constitutes a preference share for purposes of the anti-dividend stripping rules is sought.

In addition, the determination of what is an extraordinary dividend for preference share dividends is vague. Under the current rules, it is clear that any amount of dividends received by a shareholder in respect of shares other than preference shares during an 18 front period prior to a share disposal that exceeds 15% of the highest market value of that disposed share at any point in time during that 18-

month period will be tainted. However, in the case of preference shares, the use of a 15% rate without specifying the base of its application leads to uncertainties as it is not clear whether the base is the value of the preference shares on the date of disposal or at some time point in time prior to the date of disposal.

PROPOSAL

In order to provide taxpayers with clarity on the application of the anti-dividend stripping rules in the case of

To respond to the issues raised, substitution of paragraph (*a)* of the definition of extraordinary dividend is sought. Term 'extraordinary dividend' will mean, in relation to a preference share, the amount of any dividend received or accrued exceeding the amount that would have otherwise accrued with respect to that share if it was determined with respect to the considerations for which that share was issued by applying an interest rate of 15 per annum**.**

For interpretation purposes of the anti-avoidance rules, the insertion of the definition of preference share is proposed. This definition is referenced to the current definition of 'preference share' in section 8EA which provides that a preference share is any share other than an equity share or a share that is an equity shares if that equity 's dividends are determined with reference to a specified rate of interest or the time value of money.

EFFECTIVE DATE

The proposed amendments will come into operation on 19 July 2017 and apply in respect of disposals on or after that date.

3.10. Determination of an operating company for debt-financed acquisitions of controlling share interests

[Applicable provision: Section 24O of the Act]

BACKGROUND

In 2012, a special interest deduction rule that allowed interest on a debt to be

deductible when a company used that debt to acquire a controlling share interest in an operating company was introduced in section 24O of the Act. This rule was meant to discourage the use of multiple step debt-push-down structures that taxpayers would enter into solely for purposes of obtaining excessive interest deductions in respect of debt used to fund the direct or indirect acquisition of a controlling share interest in an operating company. A direct acquisition envisaged an acquisition of the shares in an operating company while an indirect acquisition envisaged the acquisition of a share interest in a holding company in relation to an operating company. This special interest deduction is only available when a shareholder company uses debt to acquire a controlling interest in an operating company.

In 2015, the provision relating to the special interest deduction was amended to align the circumstances under which the special interest deduction is granted with the underlying policy objectives. As a result, changes were made in section 24O of the Act to ensure that share interests that qualify for a special interest deduction are limited to shares the value of which is largely determined with reference to the value of shares in operating companies. In this instance, shaes in a holding company would qualify if at least 80% of their value is derived from an income producing operating company. The legislation was amended to ensure that when a holding company in relation to an operating company ceases to be a controlling company in relation to it, a redetermination should be done to determine whether the special interest deduction should still be allowed. A redetermination is also required if the operating company ceases to be an operating company as defined or if an operating company or holding company in relation to an operating company ceases to form part of the same group of companies as the company that acquired it.

REASONS FOR CHANGE

The special interest deduction is only available when a shareholder company uses debt to directly or indirectly acquire a controlling interest in an operating company. To qualify as an operating company, at least 80% of a company's receipts and accruals should constitute income as defined (i.e. gross receipts and accruals less

receipts and accruals that are exempt for tax purposes) and that income must have been generated from its business of providing goods and services. This means that for a company to qualify as an operating company, no more than 20% of its receipts and accruals should constitute exempt income (for example dividends).

Concerns have been raised as to when should an acquirer that incurs interest on a debt used to fund the acquisition of an interest in a company, determine whether that company meets the requirements. For example, the consequences for a shareholder company are not clear if a company in which shares are acquired receives or accrues a large exempt dividend during a year of assessment. In such an instance, the company is likely to not qualify as an operating company after receiving or accruing that exempt dividend. This results in a number of uncertainties, which include:

(a) It is not clear at which point in time the company ceases to be an operating company in that year of assessment. It is not clear whether a company that receives or accrues a large exempt dividend at the beginning of the year, is disqualified from being an operating company for that year or should a determination be made at the end of the year.

(b) Lastly, taxpayers are unsure whether a shareholder can continue to claim a special interest deduction in the year of assessment following one in which a company ceased to be an operating company should the requirements be met.

PROPOSAL

In order to address these concerns, it is proposed that amendments be made in the Act to clarify that the end of the year of assessment of the shareholder company should be used for purposes of determining the point in time when a shareholder company may claim the special interest deduction. This is based on the fact that generally, the end of the year of assessment of the subsidiary company whose operating company status must be determined is in most cases similar to the year end of the shareholder company.

Practical difficulties in determining whether a shareholder company is eligible for a

tax deduction during the determination is dependent on the activities of the subsidiary. However, it has become common practice (although it may not be the case for all) for taxpayers to align the year of assessment of a subsidiary company with that of its shareholder company. This is particularly common in instance where the shareholder company holds a controlling interest in the subsidiary as in the case of a shareholder company in relation to an operating company for purpose of the special interest deduction which requires that the acquirer and the operating company form part of the same group of companies as defined in section 41 of the Act.

As a result, a shareholder company will determine whether its subsidiary company qualifies as an operating company at the end of each year of assessment that the debt remains outstanding. This also clarifies the issue relating to when a subsidiary company does not qualify as an operating company at the end of one-year assessment and subsequently qualifies at the end of the following year of assessment. This is because at each end of a year assessment the income level of the subsidiary company will be determined and only when it meets the requirements, will the shareholder company be able to benefit from the special interest deduction in respect of the interest that company incurred during that year of assessment.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 January 2019 and apply in respect years of assessment commencing or after that date.

3.11. Closing of a loophole in debt relief rules

[Applicable provisions: Section 19 of the Act and paragraph 12A of the Eighth Schedule to the Act]

BACKGROUND

The debt relief rules available in the Act give rise to a taxable debt benefit in respect of a debt owed by the taxpayer if that debt is cancelled, waived,

extinguished (by way of a redemption or merger) or converted to or exchanged for shares. The tax treatment of such debt benefit depends on whether the initial debt was used to finance deductible operating expenditure or allowance assets. For example, if the initial debt was used to finance tax deductible expenditure (operating expense, for example rental expenses or employee salaries) section 19 of the Act makes provision for recoupment, i.e. reversal of income tax deductions previously granted in respect of operating expenses and inclusion in the taxable income of the taxpayer that is subject to normal tax. On the other hand, if the initial debt was used to finance capital expenditure, the acquisition of capital assets or the acquisition of allowance assets, paragraph 12A of the Eighth Schedule to the Act makes provision for the debt benefit relating to a debt to first reduce the base cost of the capital or allowance assets held by the debtor (taxpayer). This will result in a higher capital gain or a reduced capital loss when the asset is disposed of in the future.

The structure of the debt relief rules in the Act makes provision for the ordering rules that give preference to the application of other provisions of the Act, before the application of the debt relief rules. These ordering rules may result in instances where the debt relief rules do not apply because another provision of the Act is applicable. For example, if a debt reduction or cancellation constitutes property of an estate and that debt relief is reduced or cancelled in favour of an heir or legatee by virtue of a bequest, in terms of the ordering rules, the provisions of Estate Duty Act will apply and the debt relief rules will not apply in this regard. In addition, if the debt reduction or cancellation qualifies as a donation under the donations tax, according to the ordering rules, the provisions of donations tax will apply and the debt relief rules will not apply. Further, if the debt reduction or cancellation stems from an employer or employee relationship, the amount is generally viewed as taxable salary subject to pay-as-you-earn and in terms of the ordering rule, the provisions of the Fourth and Seventh schedule to the Act will apply and the debt relief rules will not apply.

REASONS FOR CHANGE

It has come to Government's attention that in some instances mentioned below,

the ordering rules may create an anomaly that may have an unintended consequence of a debt benefit that does not trigger tax implications.

A. Ordering rules - Donations tax exclusion

The ordering rules under debt relief were meant to carve out instances where another tax charge would exist in instances where a debt benefit arises in respect of a debt. However, in the case of donations tax, the exclusion has been formulated in such a manner that if an arrangement in respect of a debt constitutes a donation, the exclusion from the application of debt relief rules applies irrespective of whether donations tax is paid. In other words, if the donation qualifies for an exemption from donations tax, the ordering rules will result in the unintended consequence of neither donations tax being payable nor the triggering of the application of the debt relief rules.

B. Ordering rules - CGT exclusion

In the CGT realm, there are no tax consequences on a debt benefit that arises in respect of a debt used to fund a capital or allowance asset if the asset has been disposed of by the taxpayer and that taxpayer has no assessed capital losses. This results in instances where some taxpayers would sell their debt funded assets prior to entering into a debt relief arrangement. As a result, those taxpayers realise a lower capital gain on their asset disposal and also has no adverse tax consequences on the subsequent debt relief arrangement.

PROPOSAL

In order to address the above mentioned anomalies, it is proposed that the following amendments should be made to the Act:

A. Ordering rules - Donations tax exclusion

The donations tax exclusion under the debt relief rules should be amended to provide that the exclusion will only be available in the instance that donations tax is payable on a donation arising from a debt relief arrangement.

B. Ordering rules - CGT exclusion

Amendments should be made in the debt relief rules to provide that where a ‘concession or compromise’ arises after a capital or allowance asset has been disposed of, this will give rise to tax consequences. As a result, taxpayers will be required to determine the capital gain, capital loss or recoupment that would have resulted, had the debt benefit been determined prior to the disposal of the asset. The difference between the capital gain, capital loss or recoupment determined on the prior sale and the secondary calculation taking into account the debt benefit will result in the taxpayer recognising additional capital gain and recoupment, if any, to the extent that these were not taken into account in the year of the asset disposal.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 January 2019 and apply in respect of years of assessment commencing on or after that date.

3.12. Addressing tax avoidance through the use of collateral arrangement provisions

[Applicable provision: Section 64EB of the Act]

BACKGROUND

Since 2015, changes were made in the Act to provide relief in respect of an outright transfer of listed shares, or local or foreign government bonds in collateral lending arrangements. As a result, if a listed share, or local or foreign government bond is transferred as collateral for a lending arrangement, there are no income tax, capital gains tax and securities transfer tax implications provided that identical shares or bonds are returned to the borrower by the lender within a limited period of 24 months from the date on which the collateral arrangement was entered into.

REASONS FOR CHANGE

It has come to Government's attention that certain schemes, similar to the dividend conversion schemes identified in 2012 using securities lending arrangements, are using collateral arrangements for the benefit of foreign shareholders of local listed shares. The effect is that taxable dividends are converted into exempt payments by exploiting collateral arrangements. The conversion is essentially structured to avoid dividends tax, for example, a foreign shareholder takes out a loan with a South African resident company and uses the listed shares as collateral during the period. The resident company receives the dividend tax free (company to company exemption) and afterwards, per the collateral agreement, pays an amount (a manufactured dividend) based on the dividend received by that resident company to that foreign company, free of dividends tax.

In addition, the current wording of section 64EB creates anomalies as it specifically refers to arrangements that are implemented after the announcement or declaration of a dividend in respect of those shares. However, the dividend conversion schemes are being implemented in respect of listed shares prior to the announcement or declaration of a dividend in respect of those shares.

PROPOSAL

In order to address these concerns, it is proposed that the following amendments be made to Section 64EB of the Act:

(a) The provisions of section 64EB should be expanded to apply to dividend conversion schemes using collateral arrangements and that a deemed beneficial owner is liable for dividends tax in respect of any deemed dividend arising from the scheme;

(b) The wording of section 64EB which specifically refers to arrangements that are implemented after the announcement or declaration of a dividend in respect of those shares should be amended to address instances where the dividend conversion schemes are being implemented in respect of listed shares prior to the announcement or declaration of a dividend.

EFFECTIVE DATE

The amendments will come into operation on 1 January 2019 and apply in respect of years of assessment commencing on or after that date.

3.13. Tax implications of fruitless and wasteful expenditure in respect of public entities

[Applicable provisions: Sections 10 and 23(*o*) of the Act]

BACKGROUND

Generally, section 11*(a)* of the Act makes provision for the deduction of expenditure actually incurred in the production of income, provided such expenditure is not of capital nature. On the other hand, section 23 of the Act makes provision for limitation of deduction of certain types of expenditure, including expenditure that constitutes a corrupt activity as defined in the Prevention and Combating of Corrupt Activities Act No.12 of 2004 or expenditure that constitutes a fine or penalty imposed as a result of an unlawful activity.

The limitation of deduction of expenditure provided in section 23 of the Act does not cover fruitless and wasteful expenditure. This implies that fruitless and wasteful expenditure incurred in the production of income may qualify for income tax deduction in terms of section 11*(a)* of the Act.

REASONS FOR CHANGE

Government, through the Public Finance Management Act No.1 of 1999 (PFMA), prohibits all public entities from incurring fruitless and wasteful expenditure. Fruitless and wasteful expenditure is defined in the PFMA to mean any expenditure that was made in vain and would have been avoided had reasonable care been exercised.

PROPOSAL

Government is continuing with its efforts to ensure proper governance of public entities. In order to encourage further accountability, it is proposed that any

expenditure determined and reported by a Public Entity as fruitless and wasteful expenditure in terms of the PFMA should not be allowed as a deduction in the determination of that Public Entity's taxable income.

The PFMA does however require a public entity to take effective and appropriate disciplinary steps against any employee of the public entity who makes or permits fruitless and wasteful expenditure. Effective and appropriate steps include any actions by the public entity to recover such wasteful and fruitless expenditure from the offending employee. As a measure to ensure tax neutrality in the legislation, it is proposed that any amount of fruitless and wasteful expenditure that was not allowed as a deduction and was recovered by the public entity be deemed to be exempt from income tax during the year of assessment in which it is received or accrued.

EFFECTIVE DATE

The proposed amendment will come into operation on 1 April 2019 and apply in respect of years of assessment commencing on or after that date

3.14. Allowing newly licenced South African exchanges to utilize the REIT provisions in the Act

[Applicable provision: Section 1 of the Act]

BACKGROUND

In 2012, a unified system for taxing Real Estate Investment Trusts (REITs) was introduced in the Act. In order to qualify as a REIT for tax purposes, the entity must be a South African tax resident and securities in the entity must be a listed on the Johannesburg Stock Exchange (JSE) as securities in a REIT. The JSE has in its listing requirements a category for the listing of REIT securities in section 13 of the JSE Limited Listings Requirements.

REASON FOR CHANGE

For many years the JSE has been operating as the only exchange in South Africa.

Consequently, when the unified system for taxing REITs was introduced in the Act in 2012, one of the criteria for a company to constitute a REIT is to have shares in the company listed on the JSE as securities in a REIT. In 2016, in order to broaden competition and market participation, South Africa granted new stock exchange licenses to four operators, namely, A2X, 4AX, ZARX and EESE. The current criterium in the Act that for a company to constitute a REIT is to have shares in the company listed on the JSE as securities in a REIT becomes a barrier for the newly licensed stock exchanges because the reference in the Act refers only to JSE.

PROPOSAL

In order to cater for other South African exchanges that have recently been licensed to utilise the REIT provisions in the Act, it is proposed that the following amendments be made in the Act:

A. Listing requirements of the licensed exchanges

In order to qualify as a REIT for tax purposes, it is proposed that the newly licensed stock exchanges must have a category for the listing of REIT securities in their listing requirements and the REIT listing requirements must in terms of section 11 of the Financial Markets Act No.19 of 2012 (Financial Markets Act) have been approved by the registrar in consultation with the Minister of Finance and the approval has been given before REIT securities may be included in the listing requirement maintained by that exchange and traded on the trading facility.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 January 2019 and apply in respect of listing requirements approved in terms of section 11 of the Financial Markets Act on or after that date.

3.15. Creating more certainty on the tax treatment of doubtful debts

[Applicable provision: section 11(*j*) of the Act]

BACKGROUND

In 2015, amendments were made to the Act to provide for the change to an income tax self-assessment system. As a result, the discretions given to the SARS in administering some of the provisions of the Act, including section 11(*j*), were amended, some were removed and others reformulated.

Section 11(*j*) of the Act made provision for a deduction of an allowance to be made in respect of debts which would have been allowed as a deduction had they become bad. The allowance made in the current year of assessment is then included in the income of the taxpayer in the following year of assessment. In practice, the Commissioner applies the discretion granted in terms of section 11(*j*) and gives an allowance of 25% of the face value of doubtful debts. At times, this percentage may be increased depending upon the facts and circumstances of the specific taxpayer.

REASONS FOR CHANGE

Section 11(*j*) of the Act that gives discretion to the SARS on allowance for doubtful debts is one of the sections that were amended in 2015 in anticipation of the move to a self-assessment income tax system. Consequently, the SARS' discretion in section 11(*j*) would be deleted with effect from the date to be announced by the Minister of Finance. The new section 11(*j*) makes provision for the allowance to be claimed according to the criteria set out in a public notice issued by SARS. However, the effective date for the removal of SARS' discretion in section 11(*j*) has not yet been announced as the criteria for claiming the allowance for doubtful debts have not yet been formulated.

PROPOSAL

In order to provide certainty, it is proposed that the criteria for determining the doubtful debt allowance be specifically included in the Act. It is therefore, proposed

that the following allowances relating to doubtful debts be allowed in determining taxable income in terms of section 11(*j*) of the Act:

A. Companies using International Financial Reporting Standards (IFRS) 9 accounting standard for financial reporting purposes

It is proposed that 25% of the loss allowance relating to impairment as contemplated in IFRS 9 excluding lease receivables contemplated in IFRS 9 (because a deduction may be allowed for the lessor of leased assets in terms of section 11(*e*) of the Act) be allowed as deduction if recognised for financial reporting purposes. The allowances allowed in a year of assessment must be added back to income in the following year of assessment.

B. Companies not using IFRS 9 accounting standard for financial reporting purposes

It is proposed that an age analysis of debt be used in this regard. As a result, it is proposed that 25% of the face value of doubtful debts that are 90 days past due date be allowed as deduction. The allowances allowed in a year of assessment must be added back to income in the following year of assessment.

Example 1 - Application of 90-day rule:

Debtor fails to make full payment for 90 days after due date of an amount that is payable. The debtor is 90 days in arrears and the full debt becomes doubtful then 25% of the debt is allowed as a doubtful debt under section 11*(j)* of the Act.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 January 2019 and apply in respect of years of assessment commencing on or after that date.

3.16. Tax treatment of amounts received by or accrued to portfolios of collective investment schemes

[Applicable provision: Section 25BA(3) to (6) of the Act]

BACKGROUND

A portfolio of a Collective Investment Scheme (CIS) is basically a pool of funds created through the contributions of a number of investors and operates as an investment vehicle on behalf of those investors (holders of participatory interests or portfolio unit holders). The CIS is managed by a professional manager who, depending on the mandate of that CIS will use the contributions of the investors to invest in listed shares, bonds, property and other financial instruments. Portfolios of collective investment schemes are separate persons for income tax purposes and are in essence vesting trusts with specific timing rules for the accrual of amounts.

For income tax purposes, distributions that are not of a capital nature from a CIS to unit holders within 12 months after that income is accrued or in the case of interest is received by a CIS follow the flow through principle and are deemed to accrue to the unit holders on the date of distribution and be subject to tax in respect of the unit holders.

The Act does not provide a definition of what constitutes an amount of a capital nature. The concept of what constitutes an amount of a capital nature depends on facts and circumstances as well as the tests enunciated in case law.

REASONS FOR CHANGE

It has come to Government's attention that some CIS are in effect generating profits from the active frequent trading of shares and other financial instruments. These CIS argue that the profits are of a capital nature. They base this argument on the intention of long term investors in the CIS.

The fact that the determination of capital or revenue distinction is not explicitly stated in the Act and reliance is based on facts and circumstances as well as the case law has led to different application of the law and this has resulted in an uneven playing field regarding the taxation of CIS.

PROPOSAL

In order to provide clarity and certainty with regard to the tax treatment of CIS, the following is proposed:

A. One-year holding period rule

It is proposed that distributions from CIS to unit holders derived from the disposal of financial instruments within 12 months of their acquisition should be deemed to be income of a revenue nature and be taxable as such in the hands of the unit holders if distributed to them under current tax rules relating to distributions.

B. First-in-first-out method

It is proposed that where a CIS acquired financial instruments at various dates, the CIS will be deemed to have disposed of financial instruments acquired first. The first in first out method will be used to determine the period the financial instruments were held for the purposes of the one year holding period rule.

C. Treatment of losses

Deductions and allowances do not flow through to unit holders and amounts deemed to have accrued to unit holders are limited to amounts of gross income reduced by deductions allowable under section 11.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 March 2019 and apply in respect of financial instruments disposed of on or after that date.

3.17. *Review of venture capital company rules*

[Applicable provision: Section 12J of the Act]

BACKGROUND

Since the introduction of the Venture Capital Company (VCC) tax incentive regime in 2008, as one of the measures to encourage equity funding to a portfolio of Small, Medium and Micro-Enterprises (SMME), the uptake of the VCC tax incentive regime has grown significantly over the past two years leading to a meaningful investment into the economy.

REASONS FOR CHANGE

A. Administrative and technical issues

It has come to Government's attention that the following administrative issues and technical aspects, however, still remain as an impediment to even further uptake of the VCC tax incentive regime.

Investment income threshold test

As a legislative measure to ensure that the VCC's investment into any target company (the qualifying company) is actively used to grow the underlying business of that qualifying company, paragraph (*f*) of the definition of qualifying company in section 12J makes provision for the investment income derived by the qualifying company during any year of assessment not to exceed 20% of gross income of that qualifying company.

Several investments have been identified where the qualifying company's underlying business is both time and infrastructure intensive initially with the qualifying company only being able to generate any income, other than investment income as defined in paragraph (*f*) of the definition of qualifying company in section 12J, from the business upon the completion of the infrastructure. As such, the qualifying company can unintentionally breach the 20% investment income threshold. This has an unintended consequence of making potential investors reluctant to invest in VCCs.

<u>Controlled company test</u>

Paragraph (*b*) of the definition of qualifying company in section 12J defines a 'qualifying company' as a company that is not a 'controlled group company' in relation to a group of companies. This implies that a 'controlled group company' is a company that has a corporate shareholder that holds directly or indirectly, at least 70% of the shares in that company. This 'controlled company test' in the definition of 'qualifying company ensures that at a minimum, there is more than a 30% independent shareholding in a qualifying company apart from the VCC. However, the current provisions of section 12J are not clear as to when is the 'controlled company test' applied. At issue is whether the 'controlled company test' should only at the date of acquisition or after the date of acquisition of equity shares in a qualifying company.

<u>Connected Person Test - Withdrawal of VCC Status</u>

In 2011, a connected person test was added in section 12J as an anti-avoidance measure aimed at addressing the potential abuse regarding deduction of expenditure incurred by investors in acquiring VCC shares. This anti-avoidance measure requires the retrospective withdrawal of the VCC status and the inclusion in income of VCC of an amount equal to 125% of allowable tax deduction in respect of expenditure incurred to acquire VCC shares effective from the date of approval of the VCC. The above-mentioned retrospective withdrawal anti-avoidance measure requires the SARS to reopen assessments for previous years of assessment for both the VCC and the VCC investor, and results in administrative and financial burden, including the imposition of interest for late payment of taxes.

B. Closure of abusive schemes

In addition, concerns have been raised including reports in the public domain regarding abusive tax structures using the current VCC regime. For example, immediately before the 2018 Budget Review, some companies were advertising tax structures in media using the current VCC regime.

PROPOSAL

A. Administrative and technical issues

In order to address the administrative and technical issues obstructing the increased uptake of the VCC tax incentive regime, it is proposed that the following amendments be made in section 12J of the Act:

Investment income threshold test

It is proposed that paragraph (*f*) of the definition of qualifying company in section 12J be amended to allow for the 20% investment income threshold test to be applied at the earliest of either the year when the qualifying company starts to trade or the year after a period of 36 months from the date of acquisition of shares by the VCC in the qualifying company and every year of assessment after that.

Controlled company test

The current provisions of paragraph (*b*) of the definition of qualifying company in section 12J dealing with controlled company test are not expressly clear as to when is the test applied. It is proposed that amendments be made in paragraph (*b*) of the definition of qualifying company in section 12J to make provision for the controlled company test to be applied from the date of acquisition of shares by the VCC in the qualifying company and any time during every year of assessment after that date.

Connected Person Test-Withdrawal of VCC Status

To allow for a reduced administrative impact, the following is proposed:

(a) SARS should withdraw the VCC status during the current year of assessment in which the VCC fails to take corrective steps acceptable to SARS; and

(b) an amount equal to 125% of allowable tax deduction in respect of expenditure incurred to acquire VCC shares should be included in the income of a VCC in the year of assessment in which the VCC

status is withdrawn.

B. *Closure of abusive schemes*

In an attempt to close the abusive schemes using the current VCC regime, it is proposed that amendments be made in the definition of qualifying company and approval requirements for a VCC to limit the abuse of trading between an investor that invested in a VCC company and a qualifying company in which that VCC takes up shares.

EFFECTIVE DATE

The proposed amendment will come into operation on 1 January 2019 and apply in respect of years of assessment commencing on or after that date.

3.18. Extending the distribution period for small business funding entities

[Applicable provision: Section 30C(1)(*d*)(vi) of the Act]

BACKGROUND

In 2014 section 30C was introduced in the Act to provide income tax exemption for entities whose sole or primary objective is to provide funding to Small Medium and Micro Enterprises ('SMME's'). The main aim of the tax exemption was to assist the SMME's in alleviating the difficulty they experience in obtaining funding.

One of the conditions the small business funding entities need to comply with in order to qualify for the tax exemption is to ensure that 25% of amounts received by or accrued to them during the tax year (excluding amounts received from the disposal of assets held in that tax year) are distributed for the purpose of funding the SMME's by the end of that tax year.

REASONS FOR CHANGE

It has come to Government's attention that the ability by the small business funding entities to meet the distribution requirement of 25% of amounts received by or accrued to them during the tax year (excluding amounts received from the disposal

of assets held in that tax year) to SMME's by the end of that tax year is proving challenging more especially in cases where small business funding entities receive those amounts on or close to the last day of the tax year. As the development of SMME's is a government priority, it is the Government's objective to be supportive of entities that take initiatives in funding SMME's.

PROPOSAL

In order to better assist small business funding entities that are providing funding to SMME's, it is proposed that section 30C of the Act be amended so that small business funding entities be required to distribute or incur the obligation to distribute 25% of all amounts received or accrued from assets held during a tax year within 12 months of the end of that tax year.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 March 2019 and will apply in respect of years of assessment commencing on or after that date.

3.19. Review the write-off period for electronic communication cables

[Applicable provisions: Sections 12D and 11(*f*) of the Act]

BACKGROUND

The Income Tax Act contains rules in sections 11(*f*)(v)(*aa*), 11(*f*)(v)(*dd*) and 12D(3)(*c*) that make provision for the write-off in respect of electronic communication cables. Currently, the write-off period depends on whether such electronic communication cables are owned or leased by the taxpayer.

With regard to electronic cables defined in paragraph (c) of the definition of affected asset in section 12D(1) owned by the taxpayer and used in South Africa, the write-off period is currently 15 years. On the other hand, with regard to electronic cables defined in that section not owned by the taxpayer but the taxpayer is leasing them at a certain premium as contemplated in section

11(*f*)(v)(*aa*) and those electronic cables are used in South Africa, the write-off period is currently the number of years over which the taxpayer is entitled to use the electronic cables or 25 years whichever is the greater. Further, with regard to electronic cables not owned by the taxpayer but the taxpayer is leasing them at a certain premium and those electronic cables are used for transmission of electronic communications outside South Africa as contemplated in section 11(*f*)(v)(*dd*), the write off period is currently 15 years.

REASONS FOR CHANGE

It is important that the tax system remains up to date with technological advancements and international practice. The current write-off period in respect of the above-mentioned assets was last reviewed in 2014 in light of the international best practices. Given the technological advances and the environment that affects the useful life of these assets, both of which reduce their useful economic life, it is important that the current write-off periods be reviewed from time to time. In addition, it is important that the write-off period in respect of the above-mentioned similar assets be aligned, irrespective of whether the taxpayer owns or leases the asset.

PROPOSAL

In order to address these concerns, it is proposed that:

(a) The write-off period in respect of the abovementioned electronic cables defined in paragraph (c) of the definition of affected asset in section 12D(1) be aligned, irrespective of whether the taxpayer owns the asset or the asset is leased by the taxpayer or whether the asset is used in South Africa or the asset is used outside South Africa.

(b) The write-off period in respect of electronic cables defined in paragraph (c) of the definition of affected asset in section 12D(1) owned by the taxpayer and used in South Africa should be reduced to 10 years which will be effected by amending the current write-off period in section 12D(3)(*c*);

(c) The current rules for pipelines, transmission lines or cable or railway lines that are contained in section 11(*f*)(v) will no longer apply in respect of lines

and cables used for the transmission of electronic communication as defined in paragraph (c) of the definition of affected asset in section 12D(1). Instead a new section 11(*f*)(vi) that applies to lines and cables used for the transmission of electronic communication as defined in paragraph (c) of the definition of affected asset in section 12D(1), will be inserted.

(d) The write-off period in respect of lines and cables used for the transmission of electronic communication defined in paragraph (c) of the definition of affected asset in section 12D(1) and catered for in the new section 11(*f*)(vi), that are not owned by the taxpayer but the taxpayer is leasing those electronic cables at a certain premium, will be reduced to number of years of which the taxpayer is entitled to use the asset or 10 years, whichever is the greater.

(e) The write off period in respect of electronic cables not owned by the taxpayer but the taxpayer is leasing those electronic cables at a certain premium and those electronic cables are used for transmission of electronic communications outside South Africa as contemplated in section 11(f)(v)(dd), should be reduced to the number of years of which the taxpayer is entitled to use the asset or 10 years, whichever is the greater

EFFECTIVE DATE

The proposed amendments will come into operation on 1 April 2019 and apply in respect of assets acquired or brought into use on or after that date.

3.20. Review of international shipping rules

[Applicable provision: Section 12Q of the Act]

BACKGROUND

With effect from 1 April 2014, government introduced a new regime providing tax relief for qualifying South African shipping companies. The policy rationale for this regime was to make South Africa more competitive (as other countries were introducing tonnage tax or exempting international transport shipping income

altogether) and to attract ships to be flagged under the South African register. In order to qualify for this relief, the company at issue must be a resident and must operate one or more South African ships that are utilised in international shipping that:

(a) are registered in South Africa in terms of the Ship Registration Act No. 58 of 1998 (Ship Registration Act); and

(b) used for international transportation for reward of passengers or goods.

Tax relief provided by this regime includes exemptions from normal tax, capital gains tax, dividends tax as well as cross-border withholding tax on interest. Shipping companies qualifying for this regime also have the benefit of using a currency other than the Rand as the company's functional currency thus eliminating inadvertent currency gains and losses.

REASONS FOR CHANGE

The current exemption provided in terms of this regime is limited to South African resident companies that derive income from the operation of South African ships for purposes of international traffic. While this limitation is intended to ensure that the regime is not abused and utilised for its policy intended purpose, that is, to attract ships to be flagged under the South African register, it has the effect of creating unintended consequences in cases where a non-South African ship (non-flagged ship) is brought into use temporarily by a South African resident company as a replacement ship due to the fact that a South African ship (South African flagged ship) is not available because the South African ship is undergoing maintenance or repairs.

In view of the fact that the replacement ship is not a South African ship, the South African resident company that temporarily makes use of the replacement ship may not qualify for exemption in terms of this regime for gross income from that ship.

PROPOSAL

In order to address the above-mentioned concerns, it is proposed that amendments should be made in the definitions of '*South African ship*' and '*international shipping income*' in section 12Q of the Act to take into account

income derived by a qualifying South African company that temporarily makes use of a replacement non-South African ship for purpose of international traffic for a short period of time due to the fact that the South African ship is not available due to maintenance or repairs.

EFFECTIVE DATE

The proposed amendment will come into operation on 1 April 2019 and apply in respect of years of assessment commencing on or after that date.

3.21. Extension of employment tax incentive scheme

[Applicable provision: Section 12 of the Employment Tax Incentive Act No. 26 of 2013 (Employment Tax Incentive Act)]

BACKGROUND

The Employment Tax Incentive (ETI) was introduced in January 2014 to promote employment, particularly of young workers. After the initial 3 years of the ETI regime it was extended for a further two years. This period is set to lapse on 28 February 2019.

The first extension of ETI regime was based on a process of review and a consultation process in the National Economic Development and Labour Council (NEDLAC), which indicated modest positive effects on growth rates of youth employment in claiming firms and that significant negative effects did not materialise.

REASONS FOR CHANGE

A further extension of the ETI regime is proposed in light of the need to support youth employment, as indicated in the State of the Nation Address (SONA) delivered on 15 February 2018. In addition, as part of the on-going monitoring and evaluation of the ETI regime another round of inputs will be collected from social partners through NEDLAC this year. The on-going review process may result in further amendments being proposed in this regard. Such proposed amendments may be considered in the following legislative cycle.

PROPOSAL

In view of the above, it is proposed that the ETI regime should be extended for a further period of 5 years, from 28 February 2019 to 28 February 2024, with an interim report on its performance to be published after 3 years. 37

EFFECTIVE DATE

The proposed amendments will come into operation from the date of promulgation of the 2018 Taxation Laws Amendment Bill.

3.22. Addressing an overlap in the treatment of dividend as defined in section 1 and amount deemed as dividend in section 31

[Applicable provisions: Section 1 definition of dividend, section 31 and 64D of the Act]

BACKGROUND

A. Definition of dividend in section 1 of the Act

On 1 April 2012 dividends tax came into effect replacing the secondary tax on companies (STC) and the definition of the dividend was also revised. The definition of dividend in section 1 of the Act treats as a dividend any amount transferred or applied by a company that is a resident of South Africa for the benefit of or on behalf of any person in respect of any share in that company. An amount transferred or applied includes a distribution made by or consideration for the acquisition of any share in that company. The definition contains three exclusions, namely, amounts resulting in a reduction of contributed tax capital, where company transfers shares in that company and acquisition by a listed company of its own shares on the JSE.

B. Amount deemed as dividend in section 31 of the Act

In 2015, amendments were made in section 31 of the Act to make provision for a company making a transfer pricing secondary adjustment to deem the

amount to be a dividend consisting of a distribution of an asset *in specie* (dividend *in specie*) declared and paid by the resident company to the non-resident connected person. The deemed dividend *in specie* is currently subject to dividends tax at a rate of 20%. In addition, the dividends tax rate of 20% in respect of this deemed dividend *in specie* cannot be reduced by the application of the dividend article in the tax treaty.

REASON FOR CHANGE

Currently, there is a potential overlap between the treatment of a dividend as defined in section 1 of the Act and the treatment of an amount deemed as a dividend under the transfer pricing provisions of section 31 of the Act. Consequently, an amount deemed as a dividend *in specie* as a result of a transfer pricing secondary adjustment in terms of section 31, may depending on the facts and circumstances of the case, constitute a dividend as defined in section 1 of the Act. This overlap may also unintendedly result in tax treaty relief being available in respect of an amount deemed as a dividend *in specie* as a result of a transfer pricing secondary adjustment in terms of section 31 of the Act.

PROPOSAL

In order to address this anomaly, it is proposed that clarity should be provided in the Act that an amount deemed as a dividend *in specie* as a result of a transfer pricing secondary adjustment in terms of section 31 of the Act is excluded from the definition of dividend in section 1 of the Act.

In turn, consequential amendments should be made in section 64D of the Act to include an amount deemed as a dividend *in specie* as a result of a transfer pricing secondary adjustment in terms of section 31 of the Act, as a dividend subject to dividends tax.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 January 2019 and appy in respect of years of assessment commencing on or after that date.

3.23. Reversing exchange difference for exchange items disposed at a loss

[Applicable provision: Section 24I(4) of the Act]

BACKGROUND

In 2017, a new section 24I(4) was introduced into the Act. The new subsection (4) provides relief in respect of foreign exchange gains and losses on debt by reversing any exchange gains and losses in respect of the portion of the exchange item that has become bad. For example, where a debt owing to the taxpayer has gone bad or irrecoverable, and in previous years' foreign exchange gains or losses were included or deducted from its income, subsection (4) provides for the reversal of these amounts and therefore, previous foreign exchange gains may be deducted and previous losses must be included in the income of the taxpayer.

REASON FOR CHANGE

In instances where the exchange item is disposed at a loss by reason of a decline in the market value of that exchange item and not because the debtor is unable to pay, section 24I(4) does not provide for a reversal of the previous foreign exchange gains or losses that were included or deducted from the income of that taxpayer. This could, for example, occur where an instrument such as a foreign bond is sold on the market at a price or an amount that is less than the price or amount that was paid for it due to the changes in the prevailing interest rate.

PROPOSAL

In order to address these concerns, it is proposed that the provisions of section 24I(4) of the Act be extended to provide relief where an exchange item is disposed of at a loss as a result of market forces.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 January 2019 and apply in respect of years of assessments commencing on or after that date.

3.24. Rules addressing the use of trust to defer tax or recharacterize the nature of income

[Applicable provisions: Sections 7(8), 10B(2) and 25B(2A)of the Act and paragraphs 64B, 72(*b*) and 80(3) of the Eighth Schedule to the Act]

BACKGROUND

Government has, since 2008 been concerned that the Controlled Foreign Company (CFC) rules do not capture foreign companies held by interposed foreign trusts. In order to close this loophole, in 2017, changes were made to the CFC rules in section 9D of the Act to extend the application of the CFC rules to foreign companies held through foreign trusts and foreign foundations and whose financial results form part of the consolidated financial statements, as defined in the IFRS 10, of a group of which the parent company is resident in South Africa.

REASON FOR CHANGE

The 2017 changes to the CFC rules dealt with the issue of South African resident companies having an indirect interest in a foreign company through foreign trusts and did not address the issue of South African resident individuals having an indirect interest in a foreign company through foreign trusts.

The first 2017 Draft Taxation Laws Amendment Bill that was published for public comments on 19 July 2017, contained rules in the proposed section 25BC dealing with South African resident individuals holding shares in a foreign company through foreign trusts and foreign foundations. These rules deemed all distributions of the discretionary foreign trusts or foreign foundations to individuals and trusts to be income in the hands of South African resident beneficiaries. This was done in order to discourage the use of trusts to defer tax or recharacterise the nature of income.

Following oral presentations on the 2017 Draft TLAB at hearings held by the Parliament Standing Committee on Finance on 29 August 2017 and a meeting held with stakeholders on 18 September 2018, the above-mentioned proposed rules were withdrawn due to the wide nature and complexity and postponed to 2018

legislative cycle.

PROPOSAL

In order to close the loophole in the current tax legislation regarding the use of trusts to defer tax or recharacterise the nature of income, it is proposed that the following amendments be made to the Act:

A. *Disregarding participation exemption in respect of foreign dividends for purposes of income inclusion in terms of section 7(8) of the Act*

In determining an amount that should be included as taxable income in terms of section 7(8)(*a*) of the Act, in the hands of a resident who made a donations, settlement or other dispositions to a foreign trust and that foreign trust holds shares in a foreign company, it is proposed that the participation exemption as contemplated in section 10B(2)(*a*) of the Act in respect of foreign dividends should be disregarded, provided that those foreign dividends are paid by a foreign company where more than 50% of the total participation rights or voting rights in that foreign company, are directly or indirectly exercisable by that resident who made a donation settlement or other dispositions to a foreign trust or connected person in relation to the resident.

B. *Disregarding participation exemption in respect of foreign dividends for purposes of income inclusion in terms of section 25B of the Act*

In determining an amount that should be included as taxable income in terms of section 25B(2A) of the Act, in the hands of a resident who acquires a vested right in a foreign trust and that foreign trust holds shares in a foreign company, it is proposed that the participation exemption as contemplated in section 10B(2)(*a*) of the Act in respect of foreign dividends should be disregarded, provided that those foreign dividends are paid by a foreign company where more than 50% of the total participation rights or voting rights in that foreign company, are directly or indirectly exercisable by that resident who made a donation settlement or other dispositions to a foreign trust or connected person in relation to the resident.

C. *Disregarding participation exemption in respect of capital gains derived from the sale of foreign shares for purposes of attribution of capital gain in terms of paragraph 72 of the Eighth Schedule to the Act*

In determining an amount of capital gain that should be attributed in terms of paragraph 72 of the Eighth Schedule to the Act, in the hands of a resident who has made a donation to a foreign trust, and a capital gain is attributable to that donation in such foreign trust as a result of the sale of shares held by that foreign trust in a foreign company, it is proposed that the participation exemption as contemplated in paragraph 64B of the Eighth Schedule to the Act in respect of capital gains derived from the sale of foreign shares should be disregarded.

D. *Disregarding participation exemption in respect of capital gains derived from the sale of foreign shares for purposes of attribution of capital gain in terms of paragraph 80 of the Eighth Schedule to the Act*

In determining an amount of capital gain that should be attributed in terms of paragraph 80 of the Eighth Schedule to the Act, in the hands of a resident beneficiary, it is proposed that the participation exemption as contemplated in paragraph 64B of the Eighth Schedule to the Act in respect of capital gains derived from the sale of shares held by the foreign trust (in which a beneficiary is a resident) in a foreign company should be disregarded.

EFFECTIVE DATES

The proposed amendments will come into operation on the following dates:

(a) The proposed amendments to section 7(8) will come into operation on 1 March 2019 and applies in respect of amounts received or accrued on or after that date;

(b) The proposed amendments to section 25B will come into operation on 1 March 2018 and applies in respect of any years of assessment commencing on or after that date;

(c) The proposed amendments to paragraph 72 of the Eighth Schedule will

come into operation on 1 March 2019 and applies in respect of any amounts vesting on or after that date;

(d) The proposed amendments to paragraph 80 of the Eighth Schedule will come into operation 1 March 2019 and applies in respect of disposals on or after that date.

3.25. VAT – Insertion of the definition of 'face value' under the provisions dealing with irrecoverable debts

[Applicable provision: Section 22 of the Value Added Tax Act No. 89 of 1991 ('the VAT Act')]

BACKGROUND

A VAT registered vendor is in terms of section 22(1) of the VAT Act, permitted to claim a deduction for VAT on taxable supplies of goods or services that have been written off, if those taxable supplies were provided on credit, and the debt is irrecoverable. If that vendor cedes or sells the debt book in respect of the debt that has been written off on a non-recourse basis to another vendor, for example a collection agent or bank, for an amount that is less than the amount owing, then the sale of debt is exempt from VAT and the vendor is not required to make any adjustments to the previous VAT deduction.

REASONS FOR CHANGE

It has come to Government's attention that some vendors (for example collection agents or banks) that buy the debt book in terms of the above-mentioned arrangement then attempt to claim a further VAT deduction if they write off all or part of this debt in future. This results in a double VAT deduction, which is against the intention of the legislation as seen in the definition of 'face value of a debt transferred' in the Explanatory Memorandum to the Taxation Laws Amendment Bill, 1997.

The Explanatory Memorandum provides that the 'face value' of a debt transferred is, for the purpose of section 22(1), the net value of the account receivable at time

of transfer, after adjustments have been made for debit and credit notes and after taking into account the input tax claimed on the bad debt amount already written off by the (first / supplier) vendor.

PROPOSAL

In order to address this anomaly and prevent the double VAT deduction, it is proposed that amendments be made in section 22 of the VAT Act by inserting a definition of 'face value' to take into account the policy rationale explained in the Explanatory Memorandum to the Taxation Laws Amendment Bill, 1997.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 April 2019.

4. MEMORANDUM ON THE OBJECT OF THE TAX ADMINISTRATION LAWS AMENDMENT BILL, 2018

4.1. Retirement fund approvals – Financial Sector Conduct Authority

Section 3(5) of the Income Tax Act currently provides that SARS may delegate the function to approve a fund contemplated in the definition of a 'pension fund', 'pension preservation fund', 'provident fund', 'provident preservation fund' or 'retirement annuity fund' for purposes of the Income Tax Act to the Executive Officer of the Financial Services Board (FSB).

The function to approve retirement funds for the purposes of the Income Tax Act, 1962, was delegated to the FSB from 1 April 2012.

The Financial Sector Regulation Act, 2017 (Act No. 9 of 2017), repealed certain provisions of the Financial Services Board Act, 1990 (Act No. 97 of 1990) (the FSB Act), which impacts on the performance of certain functions entrusted to the Executive Officer by or in terms of this or any other Act.

The position of the Executive Officer of the FSB is only still in existence to finalise

the financial statements of the FSB. A new regulatory body, the Financial Sector Conduct Authority (FSCA), has been established in terms of section 56 of the Financial Sector Regulation Act with effect from 1 April 2018 to perform most of the regulatory functions previously performed by the FSB.

In order to accommodate these legislative changes, consequential amendments are required to the Income Tax Act as well as section 70 of the Tax Administration Act which currently provides for information to be disclosed to the FSB in order for it to perform its duties and functions in terms of the FSB Act which regulatory functions are performed by the FSCA with effect from 1 April 2018.

4.2. Repeal requirement to submit a return if only tax-exempt dividend received

In order to ease the compliance and administrative burden the proposed amendment repeals the requirement for a person receiving a tax-exempt dividend to submit a return.

4.3. Directors of private companies – no longer subject to PAYE, fringe benefits

The proposed amendment removes directors of private companies from the definition of employee for purposes of the Fourth Schedule. These directors are no longer subject to PAYE in terms of that Schedule in line with other amendments such as the repeal of paragraph 11C of the Schedule.

Non-executive directors of companies were removed from the definition of employee for purposes of the Fourth Schedule. Consequently, these directors are not subject to PAYE in terms of that schedule. The proposed amendment aims to deem a non-executive director to be an employee as far as a taxable benefit in terms of the Seventh Schedule is concerned. These taxable benefits are included in the definition of remuneration and hence the non-executive director will be required to pay PAYE on such taxable benefit.

4.4. Automatically a provisional taxpayer

The opening words of paragraph *(a)* of the definition of 'provisional taxpayer' provide that any person who derives any income by way of any remuneration from an unregistered employer and an amount that does not constitute remuneration or an allowance, is automatically a provisional taxpayer.

4.5. Capital gains for non-provisional taxpayer

'Income' means income as defined in section 1 of the Act. Capital gains are a direct inclusion in taxable income, and are not included in income.

Thus, if a person who receives remuneration from a registered employer (a salaried employee who is not a provisional taxpayer for any other reason) realises a capital gain, the person is not a provisional taxpayer with regards to those gains.

This creates an exception for these taxpayers to the general rule that taxes should be paid during the year of assessment and not left to final assessment.

For example, a capital gain made when an asset is disposed of on 11 March 2018, would only be disclosed to SARS when the 2019 tax return is filed on 15 September 2019, therefore more than a year and a half later. This could create problems for collecting any debt arising from that gain. The proposed amendment aims to address this issue.

4.6. Employer – 14 days before or after last day of February re. employee's tax

Currently an employer is permitted to use any date within 14 days before or after the last day of February of any year at its own discretion, without the approval of SARS, for employees' tax purposes.

This may allow an employer to manipulate its employees tax rates where there is a

change in tax rates from one year to another.

As an example, if tax rates were to decrease from 1 March, the employer could close its employees' tax year 14 days earlier, so its employees would get the benefit of the lower rate for an additional 14 days. The employees' tax year could be closed 14 days later if tax rates were to increase.

In order to address the potential manipulation an amendment is proposed that will require SARS' approval in these cases.

4.7. VAT – replaced tax invoices

It happens in practice that after a vendor, being a supplier, issues a tax invoice, the supplier is informed by the recipient that certain information (other than the information pertaining to the VAT, value or consideration of the supply), on that document is incorrect.

Technically the document issued by the supplier then does not qualify as a tax invoice.

Hence, the recipient is unable to use that document for purposes of deducting input tax and has to request the supplier to issue a document with the correct information such that it qualifies as a tax invoice as defined.

This creates uncertainty by vendors whether the issuing of a new document with the correct information will result in two tax invoices being issued for the same supply and, consequently, result in the vendor committing an offence.

The proposed amendment aims to clarify that under the circumstances described above, where a vendor, being a supplier, cancels the initial document and re-issues a document with the correct information, that vendor will not be committing an offence. The amendment will also require the supplier to maintain a proper audit trail between the initially issued document, the manner of cancellation and the re-issued document. The amendment requires a material error which means that the error is of a nature where the document in question will be precluded from being used by a vendor to deduct input tax in terms of section 16(2) of the Act, if not

corrected.

4.8. VAT – Going concern, credit note in respect of goods return

The proposed amendment aims to clarify that where an enterprise is sold as a going concern, the purchaser of the enterprise is allowed to issue a credit note in respect of goods that were supplied by the seller of the enterprise but is returned to the purchaser. The proposed amendment will ease the compliance for purchasing vendors and consequently VAT will not be a cost to the business.

4.9. VAT – Refund claims, prescription,

The policy position for VAT, being a self-assessment tax, is that the erroneous overpayment prescribes if the vendor does not claim the overpayment within a period of 5 years from the date it was paid to SARS.

Section 190(4) does not require such a claim, it merely deals with the situation if a claim is made.

The proposed amendment aims to ensure that the prescription rule prior to the introduction of the Tax Administration Act will apply and that claims will not be considered valid if the enterprise's banking details for the payment of the refund have not been provided.

4.10. VAT – Branches, set-off and recovery provisions

The Value-Added Tax Act allows a vendor that carries on enterprises in branches or divisions, to separately register such branches or divisions for VAT.

Further, the Act regards such branches or divisions as separate vendors, albeit that the branches or divisions are carried on by one and the same legal entity.

The proposed amendment aims to simplify SARS' set-off and recovery provisions and to provide legal certainty that set-off and recovery provisions will apply across

such separately registered branches and divisions. The main business and the branch operate as the same legal entity and any legal action can only be taken against the legal entity.

4.11. VAT – Members of joint venture, jointly liable

The proposed amendment aims to provide legal certainty that all the members of a joint venture may be jointly and severally liable for the VAT debts of the joint venture.

4.12. Tax Administration – Notification of start of audit

The proposed amendment aims to ensure that taxpayer be notified at the start of an audit as part of efforts to keep all parties informed.

4.13. Tax Administration – Understatement penalty

Pursuant to recent case law, it appears to be arguable that if no return is submitted, there could not be a shortfall under section 222(3)*(a)* of the Tax Administration Act as SARS would never 'accept' a failure to render a return (refer ITC 13725 & VAT1426/IT13727&VAT1096 par [25] to [27]).

Although this argument was not accepted in the case, if may be accepted in other matters.

The amendment is accordingly proposed to provide clarity on this issue. The alternative proposal is based on the possibility that if such an argument ever was accepted, it could be applicable to all the scenarios under section 222(3) as the additional assessment that SARS may impose pursuant to the understatement could conceivably result in tax chargeable under *(a)*, refundable under *(b)*, or even an amount carried forward under *(c)*.

Each one uses the amount that SARS would have 'accepted' in the calculation of the shortfall. It is, therefore, alternatively proposed that clarity is provided in respect

of the whole of subsection (3) under a new subsection (4)*(b)*.

5. TAX CASES

5.1. C:SARS v Short and another

Respondents, who were life partners, had purchased an apartment in a sectional title development in Cape Town for an agreed purchase price of R4,2 million and, pursuant to the terms of the agreement, and against payment of the aforementioned purchase price, ownership of the apartment and its stipulated associated amenities was transferred to the First Respondent subject to a right of *habitatio* registered in favour of the Second Respondent.

The aforementioned agreement was subject to the formalities prescribed in terms of the Alienation of Land Act and its terms were entrenched in a deed of alienation, dated 7 August 2009, accordingly.

It stipulated that the agreed purchase price was R4,2 million, payable to the seller's conveyancers by way of a deposit of R250 000 within five days of the acceptance of the offer to purchase, with the balance to be paid 'in cash against transfer of the Property into the name of the Purchaser.'

The Respondents had bought the apartment to be their home and the idea that the First Respondent should be registered as the sole owner, with the Second Respondent having a registered right of habitation, was intended to provide them with protection against the possibility of losing their home should the Second Respondent, who was a partner in a firm of attorneys, happen to be faced with a crippling liability in consequence of any large claim that might be made against the firm.

The registered right of *habitatio* (which would endure for his lifetime) would afford the Second Respondent security of occupation in respect of the property and by virtue of its legal character would not be exigible by his creditors.

In terms of section 14 of the Transfer Duty Act the parties to any 'transaction' by which 'property' is acquired are required to furnish declarations in the prescribed

form to SARS for transfer duty purposes

The Respondents completed separate transfer duty declarations, thereby implying that two transactions had been entailed. The First Respondent declared that she had acquired the 'bare *dominium*' of the property for a consideration of R2 869 103, 40 and the Second Respondent had separately declared that he had acquired the right of *habitatio* for a consideration of R1 330 896, 60. No mention of any consideration in the aforesaid amounts was made in the deed of alienation, but added together they make up the sum of R4,2 million that was stipulated in the contract as 'the purchase price.'

The seller, on the other hand, had made a single transfer duty declaration in which, under 'Details of purchase transaction', it was indicated that transfer duty was payable on R4,2 million 'being total consideration.' The seller's declaration gave the details of the purchaser(s)/transferee(s) as follows: the First Respondent's name ('bare *dominium* holder') and the Second Respondent's name ('right of *habitatio*').

Treated as separate transactions in accordance with the Respondents' transfer duty declarations, and because the rate of transfer duty was determined on a sliding scale in terms of section 2(1)(*b*) of the Transfer Duty Act, the total amount of duty payable would be R225 998, 49 (R174 526, 77 in respect of the declared value of the 'bare *dominium*' and R51 471, 72 in respect of the value imputed by the Second Respondent to the right of *habitatio*).

SARS had, however, determined that the transfer duty fell to be calculated in the amount of R281 000 with reference to the agreed consideration of R4,2 million in respect of a single transaction.

Respondents paid the transfer duty in the amount assessed by SARS under protest and their subsequent appeal against SARS' determination was upheld by the Tax Board and thereafter, on rehearing in terms of section 115 of the Tax Administration Act, also by the Tax Court.

It was common ground between the parties that a right of *habitatio* constituted a limited real right in land and qualified as 'property' under para (*a*) of the definition in

s 1 of the Transfer Duty Act.

The present appeal turned on whether there was one ‘transaction’, as contended by SARS, or two ‘transactions’, as contended by the Respondents.

Judge Binns-Ward held the following:

(i) That the fact that the seller had made a single transfer duty declaration necessarily implied that it considered that its disposal of the property had involved a single transaction.

(ii) That in order for the Respondents’ contention that there had been two transactions to prevail, the reservation of a right of *habitatio* to the Second Respondent would have to be an acquisition that was independent of, and not integral to, the transfer of title of the property from the seller to the First Respondent and, for transfer duty purposes, an objective determination had to be made whether one or two transactions were in fact involved and that turned on the proper construction of the parties’ contract.

(iii) That the fact that separately registerable rights were to be acquired by the purchasers was not determinative. It is authoritatively established that a multiplicity of individually registerable properties of various values may be the subject of a single transaction for transfer duty purposes, *vide CIR* v *Freddies Consolidated Mines Ltd* 21 SATC 132 in which the character of the dispute over the calculation of transfer duty was closely analogous to that in the current case.

(iv) That in the *Freddies Consolidated Mines* case, *supra*, the Appellate Division upheld the Commissioner’s assessment and it did so primarily on the basis that the sale of the several units of land listed separately on the annexures to each of the agreements had in each case formed an integral part of a single indivisible transaction.

(iv) That it also did not matter that in the current case there were two purchasers, each of which was to acquire different rights in the property and the principle still applies if they were to do so in terms of ‘a unitary transaction.’

(v) That it was therefore necessary to examine the agreement in more detail to determine whether it did indeed establish that the rights of the Respondents to acquire property thereunder involved an integral transaction.

(vi) That the rules of interpretation are so well-established that it would be a supererogation to set them out in detail. Suffice it to say that central to the exercise of interpreting a written contract is construing the language used in the deed with appropriate regard to the particular context. Context in this respect is not limited only to the immediate context of the words used within the four corners of the contract, but also involves having regard to its apparent nature and purpose; all of that to be judged against the relevant factual *matrix* in which the contract was concluded.

(vii) That within the limits of the language used by the parties read in its context in the sense aforementioned it is also necessary to approach the construction of the contract with sensible regard to the business or practical result the parties apparently sought to achieve thereby. 'Sophisticated semantic analysis' should not be permitted to negate an evident commercial or practical object that the parties clearly sought to achieve by entering into the contract.

(ix) That there were a great number of salient pointers in the deed of agreement to there having been only a single indivisible transaction in contemplation by the contracting parties. So many, in fact, that it would unnecessarily extend the length of this judgment to spell each of them out and the court confined itself to those that it considered especially significant and their effect was overwhelming.

(x) That the ordinary import of the language of the contract, when it was read as a whole, went against the meaning contended for by the Respondents and their contention also flew in the face of any commercial sense as between themselves and the seller and therefore it could not prevail.

(xi) That in upholding the Respondents' appeal the Tax Court had led itself into error by being distracted by the fact that each of the purchasers stood to acquire separate and distinctive rights in the property under the agreement.

The fact begged the question whether the acquisitions were in terms of a single integral (or unitary) transaction or two transactions. The court *a quo* also allowed itself to be misled by the SARS' acceptance that the right of *habitatio*, separately assessed, had been correctly valued in accordance with the SARS handbook for transfer duty purposes. That was not the question for decision, however. SARS contested the validity of a separate valuation of the *habitatio* in the circumstances and the notional value of the right of *habitatio* assessed independently of the transaction value was irrelevant if only one transaction was involved.

(xii) That, therefore, it followed that the appeal had to succeed.

The appeal from the Tax Court was upheld.

5.2. ITC 1906 – Deduction – Social Development Expenditure

The taxpayer, a close corporation, had carried on the business of supplying 'agricultural inputs' to farmers, such as lime and gypsum, and its principal clients were farmers in Kwazulu-Natal and a component of its business and profit arose out of government tenders involving the supply of such products for agricultural purposes.

One of the taxpayer's customers was E Entity which was also in the business of tendering for government work in the agricultural sector and it prepared lands and planted crops.

SARS had been engaged during 2015 in an investigation concerning the taxpayer's financial statements for the 2014 tax year and had noticed a peculiar operating expense of R2 million described as 'Social Development Expenditure' in the 2013 comparative column of the 2014 statement of comprehensive income.

This resulted in an audit of the taxpayer's 2013 tax year and this led to an examination of the taxpayer's 2013 financial statements, which recorded the expense, and the tax return submitted by the taxpayer for that year.

SARS could not immediately see the R2 million expense claim in the return but did

note that the block headed 'Other Expenses' reflected expenses of R2 576 145. The form of return required the taxpayer to provide descriptions of the 'other expenses' and there the taxpayer had entered the words 'Motor Vehicle Expense *etc*.'

SARS had correctly surmised that if the expenditure of R2 million on social development expenditure featured in the tax return then the expense had to form part of the sum of R2 576 145 and it was clear then, judging from the tax return, that the taxpayer had regarded the sum of R2 million as a deductible expense for the purposes of taxation.

SARS, through his representative, Ms D, then issued a 'Findings Letter' which conveys to a taxpayer that it is proposed to make certain findings with respect to the matter at hand if representations from the taxpayer delivered within 21 days do not indicate why that should not be done.

The aforementioned Findings Letter apparently warned of the proposed disallowance of the deduction of the sum of R2 million from the gross profit declared in the tax return.

A 'Finalisation of Audit' letter followed which recorded that the audit of the taxpayer's return had been finalised and that the decisions made, and recorded in the letter, would be reflected in a notice of assessment which would be issued shortly.

SARS thereafter raised an additional assessment against the taxpayer in respect of the 2013 tax year which recognised an additional R2 million of taxable income in the taxpayer's hands and its income tax for the year was adjusted upwards by R560 000 and a 100% understatement penalty was imposed.

The taxpayer's accountant, Mr C, then lodged a notice of objection which stated, *inter alia*, that during the year of assessment in issue the taxpayer had supplied goods to a customer for the benefit of a rural community and during discussions prior to the transaction, comments were made by the customer that certain benefits would have to be passed back to the community as a form of upliftment or social responsibility expenditure and an amount of R2 million was discussed.

When the company invoiced the goods it was told that the amount that was to be settled was R2 million less than the amount that had been invoiced and the company therefore passed a credit note against the various invoices and had receipted an amount equal to the sum of the invoices raised less the agreed credit note.

The letter of objection, having stated those facts, then recorded further that 'for the purposes of disclosure' in the financial statements the company decided to show sales as the amount invoiced, and disclosed the credit note as corporate social expenditure and it was alleged and then argued that the R2 million was 'never received or accrued' and was therefore neither recorded in taxable income nor claimed under section 11(*a*) of the Income Tax Act.

SARS thereafter advised the taxpayer that its objection had been disallowed and the reason given was that the expense of R2 million was neither incurred in the production of income nor was it a donation and no proper documentation had been submitted to substantiate the expense and the understatement penalty was retained.

The taxpayer then appealed to the Tax Court against the imposition of both the additional tax and the penalty and a notice of appeal followed with a letter explaining why the taxpayer had insisted that no adjustment to the original assessment was necessary.

The taxpayer, in its statement of grounds of appeal, no longer contended that when it invoiced for certain goods it was told 'that the amount that was to be settled was R2 million less than the amount that had been invoiced' and there was also no talk of a price reduction according to the statement of the grounds of appeal.

The taxpayer, in its statement of grounds of appeal as required by Rule 32, stated that E Entity had approached it for the purposes of making a donation to a community upliftment initiative called the V Trust. The taxpayer had decided that it was prepared to make a cash donation if it obtained bank account details and it was established that the Trust was a 'section 18A approved organisation.' However neither of those conditions was satisfied and it was accordingly proposed by E Entity 'that the amount of R2 million be gifted to the initiative by passing a credit

note to E Entity and E Entity making the necessary arrangements to transfer the R2 million to the initiative through whatever means was appropriate' and it was to that end that the credit note was passed.

The taxpayer, at the appeal hearing, sought leave to amend its statement of grounds of appeal which was granted in the absence of opposition from SARS.

The taxpayer modified the description of the transaction with a view to avoiding the proposition that in agreeing to the scheme it had intended itself to make a donation to the Trust and stated that the amount of R2 million was to be deducted from the purchase price of products sold by the taxpayer to the buyer and a credit note was to be issued to the buyer to reflect such price reduction and the buyer would make arrangements to pass on this benefit to the V Trust through whatever means it considered appropriate.

However, the taxpayer's sole member, Mr B, also gave evidence and accepted the proposition that what was intended was that E Entity would pay the community R2 million or perhaps give R2 million worth of something or other to the community on behalf of the taxpayer, in exchange for which a sum of R2 million was to be credited to E Entity's account with the taxpayer.

SARS conceded that while there are circumstances in which social development expenditure may legitimately be claimed as an expense deductible from gross income for tax purposes, the evidence in this case was not expanded upon in an attempt to make a case for the proposition that such a deduction would be permissible in this case.

Judge Olsen held the following:

<u>As to whether the social development expenditure was deductible</u>

(i) That the only proper construction of the taxpayer's statement of grounds of appeal delivered in terms of the Rules, was that the arrangement between the taxpayer and its customer involved the taxpayer making a gift to the Trust, or the body alleged to be a trust, and E Entity implementing that decision for the taxpayer.

(ii) That the reason for the taxpayer amending its statement of grounds of

appeal appeared to be the fact that, as it had done during the objection process, it had intended to make no attempt in the appeal to justify the classification of the R2 million as a deductible expense in both its financial statements and its tax return and that is to say that it intended to make no attempt to establish that the deduction passed muster under s 11(a) of the Income Tax Act.

(iii) That the taxpayer intended to persist with the proposition that the credit note it relied on served to reduce the accrual of income to it from its business with E Entity by R2 million and, indeed, both the amended and unamended statements of grounds of appeal contain the statement that 'The R2 million which did not constitute gross income as defined, was excluded from gross income for the purposes of determining tax or income and therefore could not have been, and was not, deducted in terms of s 11(a).'

(iv) That, however, as a matter of fact, in both the tax return and the financial statements of the taxpayer, the R2 million was included in gross income, and was reflected as an expense. Given its declared type, the expense had to pass muster under s 11(a) of the Income Tax Act and, even assuming that the credit note still operated, i.e. it had not been reversed by a journal entry, and that it was of the type which could validly be regarded as reducing accruals, the fact that it could only justify a reduction of accruals of R1 754 385,96 was simply ignored.

(iv) That when he gave evidence Mr C persisted in claiming that the credit note was the product of agreed price reductions, claiming that he got this from his discussion with Mr B. As will be seen Mr B's evidence left no room at all for a finding that there had been agreement on price reductions and the court found it difficult to accept that Mr C genuinely believed that there had been an agreement on price reductions. He made no attempt to identify the prices in question and the reduction agreed upon. It was not without significance that classifying the causa for the credit note as 'price reductions' opened the way to the argument that the effect of the credit note was to reduce the accruals forming part of gross income for the year.

(v) That Mr B's evidence appeared substantially credible and reliable to the extent that it concerned matters which were actually within his knowledge when he accepted the proposition that what was intended was that E Entity would pay the community R2 million on behalf of the taxpayer in exchange for which a sum of R2 million was to be credited to E Entity's account with the taxpayer.

(vi) That while it was conceded that there were circumstances in which social development expenditure may legitimately be claimed as an expense deductible from gross income for tax purposes, Mr B's evidence was not expanded upon in an attempt to make a case for the proposition that such a deduction would be permissible in this case. On the contrary, despite Mr B's evidence, this appeal was pursued to the end upon the basis that Mr C's argument was correct and, in the court's view, it was not.

(vii) That SARS was not satisfied when his audit was complete either that the community trust existed or that there had been any social development expenditure made at all, as claimed in the tax return and the financial statements. No evidence was led in this appeal to establish that such expenditure had been made. E Entity could have been called to state and prove how it had expended the R2 million which it would have had to pay the taxpayer but for the credit in that amount passed on its account with the taxpayer but that was not done.

(ix) That, accordingly, the taxpayer had failed to discharge the burden placed upon it in terms of section 102 of the Tax Administration Act of proving that the sum of R2 million was spent and was deductible, as suggested by the financial statements and tax return of the taxpayer or that the sum of R2 million may be set off against the accruals enjoyed by the taxpayer by reason of the invoices rendered to E Entity, as suggested by the taxpayer's accountant.

(x) That Mr B's evidence revealed the 'real substance and purpose' of the transaction and it was plain that the undertaking by E Entity to pass the R2 million, or the benefit of it, to the community was intended to substitute for payment of R2 million of the debt accumulated by E Entity in its dealings

with the taxpayer. The amount was made available by passing the journal credit (as opposed to any credit note which might be passed, for instance, to reflect an agreed discount or a price reduction) on E Entity's account. R2 million of the debt which had accrued in favour of the taxpayer was thereby discharged and it was in effect paid by set-off and it did not disturb any of the accruals in favour of the taxpayer generated by its business with E Entity and the appeal against the additional assessment for tax accordingly failed.

As to the appeal against the understatement penalty

(xi) That SARS had determined that the understatement in this case was the product of 'gross negligence' which generated a penalty of 100% of the tax raised in the taxpayer's additional assessment and he had accordingly discounted a conclusion that this was intentional tax evasion, carrying a penalty of 150%.

(xii) That the next lowest penalty percentage was 50% and the circumstances which give rise to a penalty of 50% are not defined in terms of fault, but rather with respect to the existence of a certain state of affairs, namely the absence of reasonable grounds for the tax position taken by the taxpayer.

(xiii) That this court has not been able to discern reasonable grounds for the tax position taken by the taxpayer with regard to the sum of R2 million. The tax position taken by the taxpayer in its return was not sought to be supported through an attempt to establish not only that the social expenditure was actually made, but also that it satisfied the test stated in section 11(a) and did not offend section 23(g) of the Act and, accordingly, if the court overturned SARS' decision that this case was one of gross negligence, a reduction of the penalty to 50% of the tax would be called for.

(xiv) That the first question to be considered was the approach to be adopted by the court in an appeal against a decision made by SARS with regard to an understatement penalty. Section 129(3) of the Tax Administration Act provided that in such an appeal 'the tax court must decide the matter on the basis that the burden of proof is upon SARS and may reduce, confirm or

increase the understatement penalty.'

(xv) That in CIR v Da Costa the question arose as to whether a special court hearing tax appeals could interfere with the decision of SARS only when the discretion was exercised on an incorrect basis or unreasonably or whether the tax court exercises its own discretion starting with a clean sheet of paper. The court in Da Costa held that in cases involving the exercise of a discretion by SARS the court is called upon to exercise its own, original, discretion as it is not a court of appeal but is a court of revision.

(xvi) That there seemed to be no reason to regard the function or role of a tax court convened under the Tax Administration Act as any different to that of the special court under the legislation considered in Da Costa and, if that was correct, then the question for this court was whether or not the present case involved gross negligence on the part of the taxpayer.

(xvii) That it was clear that the 'tax position' adopted by the taxpayer was the product of advice given by the accountant and this was a case of 'misguided reliance by a [member of a close corporation] on incorrect professional advice' and that did not support a conclusion that the case was one of gross negligence.

(xviii) That, accordingly, the penalty in this case must be reduced to 50% on the basis that this was a case where there was an absence of reasonable grounds for the tax position taken by the taxpayer.

5.3. ITC 1907 – Mining – Mining operations

The taxpayer had carried on business as a 'contract miner' and the evidence adduced and the undisputed facts alleged in the taxpayer's grounds of appeal showed that its activities fell squarely into the generic concept of a 'contract miner' model.

The pertinent generic characteristics of a contract miner were, *inter alia*, that:

- It had the skilled personnel and technological capacity to extract material from the Earth through open cast mining techniques;
- It concluded agreements, as an independent contractor, with other persons, typically mining right holders, to extract material from the Earth for reward payable to it by the mining right holder;
- The remuneration earned for such activity was paid by the mining right holder in several ways, including a fixed regular fee, a fixed rate for volume of material extracted, and a fixed rate by weight of the material extracted, including the identifiable mineral, the pursuit of which is the *raison d'etre* of the entire enterprise of the mining right holder;
- Payment falls due upon delivery, in a prescribed form, of the mineral or the ore bearing the mineral to the mining right holder. Depending on the mineral being mined, the delivered ore may require further refinement prior to sale or, as in the case of coal, is at once capable of being sold;
- It purchases and owns all the equipment required to meet its contractual obligations to the mining right holder and bears the full cost of maintenance thereof itself;
- It is never the owner of the land upon which the pit is located, nor the holder of the mining right, nor is it involved in any way in the marketing and sale of the minerals extracted by its efforts.

It was common cause that the taxpayer's work activities and remuneration structure included the following features:

- Blasting of rocks, excavation and transportation of topsoil, parting and overburden;
- Separate blasting and removal of different categories of chromitite and chromite ore to prevent contamination;
- Crushing and screening of ore into three different size fractions to facilitate the next process of mineral extraction; liability and risk of the imposition of a penalty was imposed upon the taxpayer in the event that the delivered product failed to meet a prescribed 'clean' threshold, *i.e.* too much ore and not enough mineral;

- Extraction of chromite ore, not for the taxpayer's own account, but on behalf of and for the benefit of the taxpayer's client in whom the ownership of the chromite ore vested throughout;
- The fees earned by the taxpayer for the services rendered to its clients were calculated to include a fixed monthly fee, extraction and delivery of ore fee at a rate per cubic metre and a crushing and screening of ore fee at a rate per ton.

In addition to the above, the following features were present:

- The taxpayer did not hold any mining licence in respect of the mining areas on which it performed the services;
- The mining right holders, and not the taxpayer, were responsible for working the ore to extract chrome after taking delivery of the product from the taxpayer;
- The mining right holders operated their smelter to extract chromium to produce ferrochrome;
- The taxpayer extracted the raw ore in a condition where chromium is unseparated from the host rock and the taxpayer was never involved in the process of final separation of the mineral from the host rock;
- The mining right holders derived their income from the sale of ferrochrome and chrome alloy extracted from the ore, which included some of the ore delivered by the taxpayer.

The crisp question for determination in this appeal was whether or not the taxpayer was eligible to deduct its capital expenditure in terms of section 15(*a*) of the Income Tax Act on the grounds that its income had been 'derived from mining operations.'

SARS had disallowed the deductions in question for the relevant years of assessment and had imposed interest on the unpaid tax in terms of section 89*quat*(2) of the Income Tax Act and penalty charges on the premise of understatements of income as contemplated in sections 222 and 223 of the Tax Administration Act 28 of 2011 and the applicability of these impositions was also in dispute.

SARS contended that the income of the taxpayer was derived from ‘services rendered’ to its client, being the mining right holder, and was not income derived from ‘mining operations’ as defined in section 1 of the Income Tax Act and therefore the deductions under section 15, read with section 36 of the Act, were not deductible as the taxpayer’s income was not ‘derived from mining operations.’

SARS was of the view that the true *locus* of the controversy was whether the income derived by the taxpayer from payments made to it by the mining right holder could, upon a proper interpretation of section 15, which had to be read with section 36 of the Act, be understood to be ‘income derived from mining operations’, even if it is so that, in ordinary parlance, such a taxpayer is, somehow or other, perceived as being implicated in ‘mining operations.’

SARS emphasised that what in its view needed to be established was that a taxpayer who is properly eligible for the section 15 benefit, must be able to show a direct connection to mining operations as the source of its income and in that context, the question of whether or not such a taxpayer undertakes any commercial risks was pertinent.

The taxpayer contended that even though it was operating on the basis of a charge which related to its inputs and efforts rather than receiving a share of profits, it was undertaking mining operations because it was conducting a process by which a mineral is won from the earth and, as a consequence, the income which it derived would be taxed in accordance with mining tax rates and the expenditures will be deductible in accordance with the special mining tax provisions.

Judge Sutherland held the following:

As to the extraction of minerals

(i) That it is well-established in law, that mere extraction of a mineral from its natural state does not result in the production of income, even though self-evidently, expenditure, including capital expenditure, must have been incurred to achieve that result.

(ii) That what is required is an engagement in the ‘trade’ of mining and this trade, typically, would include the selling of the minerals so extracted, with

the logical risks attendant on such a business.

(iii) That, in this context, it is SARS' perspective that the inter-positioning of an external contractor to extract minerals for a mining right holder against a fixed rate of pay, breaks the critical 'connection' between the fee disbursed to the contractor and the 'mining' source of that income. The mining right holder, having got a contractor to perform the actual extraction of material for it, is more properly to be regarded as the person or entity engaged in mining operations, and the contractor is, in law, too remote from the income derived from the mining operations, (i.e. the income that the mining right holder receives from the sale of the minerals and with which it is enabled to pay the contractor) to be able to say that the contractor's income, i.e. the payment from the mining right holder, is derived from 'mining operations' as defined.

(iv) That the issue at stake in these proceedings is whether a proper interpretation of the legislation supports this view.

<u>As to the meaning of 'mining operations'</u>

(v) That the phrase 'mining operations' is defined broadly in section 1 of the Act and this text is a term of art. First, the quaint, and pleasingly anachronistic, phrase 'won from the soil' has been the subject of much of the judicial interpretation. There are two main themes in the case law on its interpretation; first, a gloss on what it means to 'win' minerals, and secondly, the need to be involved in the 'trade' of mining which incorporates the unavoidable 'commercial' dimension of dealing in minerals after having been 'won.'

(vi) That 'won from the soil' suggests that the operations to dig out the earth beneath our feet is contemplated. Won from 'any substance' and won from a 'constituent' of soil suggests the inclusion of processes that might be quite distinct and physically separate from the actual digging of stuff out of the ground, but nevertheless remain 'mining operations.' However, the whole text contains more than this phrase and the impact of another phrase '. . . include every method or process by which . . .'needs also to be assessed.

(vii) That it seemed to the court that the choice of the term 'every' in this context is not compatible with a notion of segmented eligibility. Moreover, although this term is not the focus of any of the authorities, a traverse of the cases reveals a rejection of the idea that a taxpayer can fall into the defined category by reason of an 'involvement' in a 'part' of 'mining operations.'

(viii) That the recognition that the idea of 'mining' implicates more than one process is critical and 'mining' means the efforts to reach, to extract and to access metal in turn, and is thus what 'winning' the mineral is about. Moreover, when the Act refers to 'income derived from mining/mining operations' this is a reference to income derived from a business of mining and not merely a physical act and it is the totality of that organisation, of that enterprise and the totality of the conduct of the business which is 'the operation of a mine' within the meaning of the legislation and, plainly, it seemed that to be a 'digger' is not enough to be a 'miner', in the sense contemplated by the authorities referred to.

(ix) That in Western Platinum Ltd v C: SARS 67 SATC 1 it was held that mining operations by themselves cannot produce income and since there can be no derivation of income without commercial activity, we are entitled to read that into the definition and one would therefore, at least, have to interpose a sale and the associated delivery and payment between the extraction of the minerals and the income, thus postulating a business.

(ix) That what the authorities imply is that the forensic enquiry about 'income' and its source is an exercise in which one begins by first identifying exactly what constitutes the 'income'. If, as in the example postulated in Western Platinum supra, it is money obtained from a sale, then one goes on to ask: what was sold? In that example it was the mineral that was sold and the 'connection' to the mining as the source of the payment is established. On the other hand, if what constitutes the 'income' is a fee, one would ask what was the quid pro quo. Obviously, the fee is the reward for services rendered. But to say that is to give voice to a neutral generic fact. What work justified the fee may be a more useful question to ask. If the answer to that question is that the creditor dug minerals out of the earth, that

description is incomplete. The full answer would include the significant fact that in fulfilment of a contract to extract minerals from the earth, for the benefit of the debtor, the creditor becomes entitled to the agreed fee.

(x) That, in this context, the taxpayer whose undertaking it is to extract topsoil, overburden, and chrome bearing ore is undoubtedly a digger, but is not a miner, as defined, for what its enterprise comprises is merely the physical activity of extraction, but not the broader enterprise of 'mining operations.'

(xi) That SARS was right to lay emphasis, first, on the critical fact that what is delivered by the taxpayer is crushed ore which is not in a state to be marketed, and awaits further processing by the client mining right holder to turn it into a commodity that can command interest from potential customers, and second, on the contractual entitlement to a reward as the source of the 'income' it earns.

(xii) That the poverty of the notion that 'mining operations' can be constituted merely by 'extractive operations' has long been exposed and, accordingly, in the chain of activity which constitutes 'mining operations' it seems plain that the mere activity of extraction is a necessary but not sufficient attribute for the taxpayer to fall into the class of persons involved in 'mining operations' and at the other end of the process spectrum, once the material is 'isolated' any further activity to convert the mineral into a substance that does not exist in a natural state, cannot be 'mining operations' as defined.

(xiii) That mere extraction is not enough to render a contractor who earns a fee for extraction as a person eligible to fall into the class of persons who are engaged in 'mining operations' as defined. The contractor is not in the 'trade' of mining; rather the contractor is in the trade of servicing a miner's requirements by the extraction of material.

(xiv) That, accordingly, the critical enquiry is into the 'connection' between 'income' and 'source' and whether the connection between the mining operations and the income is broken by an intervening happening. This is the reason why it is not appropriate to try to disaggregate bits and pieces of overall mining operations, as if they could constitute self-standing trades or businesses of 'mining operations.' Accordingly, the taxpayer was not, in the

defined sense, involved in 'mining operations.'

<u>As to the special capital deduction benefit in section 15</u>

(xv) That taxation legislation is a special type of law-making. Its content consists of a plethora of levies on taxpayers, complicated by the invention of different classes of taxpayers, and by the conferring of benefits to some classes of taxpayers and not to others, on innumerable grounds.

(xvi) That the foremost characteristic of taxation is that it is an instrument of economic and social policy, by its very nature variable, pragmatic and responsive to changing circumstances in society. In that role, its very purpose is to engineer various economic and social outcomes by the conferring of benefits or the exclusion of some taxpayers from benefits widely conferred. Accordingly, it is no criticism of the legislation that some taxpayers are favoured and others are not. Moreover, as a result, it is not imperative to squeeze the language employed in the legislation to broaden the ambit of special privileges conferred on a particular class of taxpayer on grounds of equity or in pursuit of 'tax neutrality.' The decision to favour some and not others is firmly within the legislative sphere and it is for this reason that where a special benefit is conferred, the provisions are to be strictly construed.

(xvii) That, ordinarily, a taxpayer who incurs capital expenditure cannot deduct it all in the fiscal year in which it was disbursed but must amortise it over a number of years, as prescribed, the periods thus determined being the notional lifetime of the assets depreciated by wear and tear, or some other expressly articulated formula. Only in two classes of taxpayer is capital expenditure, in whole, in the year of disbursement, allowed: farmers and miners.

(xviii) That section 15 of the Act cannot stand alone and, indeed, to read that section alone does not inform the reader as to what may be deducted and section 36, to which reference is made, is integral to the coherence of section 15. The portions of section 36 relevant to this controversy are sub-sections (7C), (7E), (7F), (7G), and (10) and the identification of what 'capital expenditure' in terms of section 15, may be deducted occurs in sub-

section (7C).

(xix) That the court, independently of its finding in regard to the meaning of 'mining operations' in regard to the taxpayer, proceeded to determine whether the taxpayer's capital expenditure was of a kind that was eligible for the deduction provided for in sections 15 and 36 of the Act.

(xx) That in section 36(7C) the first of two critical dimensions of the deduction of capital expenditure is addressed, i.e. the section 15 deduction is available only in respect of a 'producing mine' and the introduction of the concept of a 'producing mine' is plainly a serious constriction of the scope of the deduction benefit: i.e. not every mine can qualify and from this provision it must be inferred that the benefit is aimed at a limited class of miners, and a mine that fails to 'win' any minerals cannot be a 'producing mine.'

(xxi) That the second crucial theme about deducting capital expenditure that is addressed is the principle of ring-fencing the entitlement to deduct capital expenditure to a specific mine, rather than availing a deduction to the taxpayer in relation to its entire operations and this appears in section 36(10) and each of the three sub-sections referred to by section 36(7C) address the implementation of the deduction in ways that again emphasise the restriction of the scope of the benefit.

(xxii) That the provisions of section 36(7E) make it clear that the claimed deduction must dance and remain in hold with a specified revenue stream, which like the capital expenditure itself, has to be linked to a particular mine, and not to the taxpayer's broader business operations.

(xxiii) That the upshot of the provisions in section 36 of the Act was that the section 15 deduction entitlement can be available only to taxpayers whose 'mining operations' involve capital expenditure of the nature described which is capable of computation by these formulae. Taxpayers whose 'mining operations' involve 'capital expenditure' that cannot fit into this straitjacket are not taxpayers who fall into the class intended to be beneficiaries of the special up-front capital deduction benefit.

(xxiv) That the insurmountable problem that the taxpayer faces is claiming the deduction within the context of the ring-fencing structure inherent in the

benefit.

(xxv) That the historical context in which the benefit has existed serves to illustrate that the benefit is not, was not and cannot have been envisaged as one which a taxpayer who operates as a contract miner could be entitled to enjoy.

(xxvi) That, accordingly, independently of the court's finding regarding the definition of 'mining operations', the taxpayer's capital expenditure was not of the kind that the capital expenditure of the taxpayer was eligible for the deduction provided for in sections 15 and 36 of the Act.

As to the applicability of understatement penalties

(xxvii) That the issue before the court was whether there were grounds to remit the understatement penalty of 25% as contemplated in section 223(3) of the Tax Administration Act 28 that had been imposed by SARS in terms of sections 222 and 223 of this Act.

(xxviii) That section 223(3) of the Act provided that SARS must remit a 'penalty' imposed for a 'substantial understatement' if he is satisfied that the taxpayer made full disclosure of the arrangement that gave rise to the prejudice to SARS or the fiscus by no later than the date that the relevant return was due and was in possession of an opinion by an independent registered tax practitioner that, inter alia, was based upon full disclosure of the specific facts and circumstances of the arrangement.

(xxix) That there were no material disputes of fact about the case put forward by the taxpayer but there were substantial differences in the contentions about what inferences may properly be drawn from the facts and the key premise was that the taxpayer had acted under advice and was thus bona fide and reasonable within the meaning of section 223, thus deserving of amelioration of the penalties.

(xxx) That the taxpayer at the relevant time was the wholly owned subsidiary of a holding company and the holding company had obtained advice, not the taxpayer per se. Ordinarily, nothing would turn on this distinction if the advice sought was to advise about the operations of the taxpayer but that was not the case in this matter as the advice sought was in respect of other

subsidiaries.

(xxxi) That, however, the business model of the taxpayer was, for the purpose of the advice sought, indistinguishable from the entities in respect of which the advice was given and in this case there were no material differences between the taxpayer and the other subsidiaries.

(xxxii) That, however, the evidence that, as a fact, this advice was truly relied on by the taxpayer's executive decision makers was thin. The fact of the existence of the advice was revealed very late in the progress of this appeal and no explanation was offered as to why that was so. More importantly, was the absence of its disclosure when the appeal against the imposition of interest and penalties was lodged and, most damningly, there was no evidence that the taxpayer's executives knew that the advice existed when the returns were submitted.

(xxxiii) That, even assuming that the allegations of knowledge had been established, an examination of the advice itself disclosed that the holding company had been informed unequivocally that SARS' stand was that contract miners could not claim the section 15 deduction and the advice was that acting in accordance with a contrary viewpoint to that of SARS would almost guarantee contestation.

(xxxiv) That the taxpayer did not heed the advice, especially the critical advice to make 'full disclosure' to SARS and that injunction implied that, upon making the returns, that the status of the taxpayer as a contract miner be expressly stated, and that a motivation be advanced as to why it was appropriate to claim the deduction but the taxpayer did nothing of the sort.

(xxxv) That the advice in question, at best, was advice to resist SARS' view, if it dared, on the premise that a case could be made for eligibility but the substance of the advice was superficial, did not deal meaningfully with the well-known authorities and, most strikingly, did not set out a thesis to present in defence of the taxpayer's case and the impression made by the documents was that the 'advice' was preliminary in nature, rather than the rendering of a firm opinion.

(xxxvi) That no case was made out that the taxpayer, in terms of this advice, had

any reasonable basis to conclude that it was acting in accordance with a well-considered view of the application of the law that could trump SARS' view.

(xxxvii) That, accordingly, there were no grounds upon which to conclude that the penalty impositions in terms of section 223 of the Tax Administration Act or the imposition of interest in terms of section 89quat(2) of Act ought to be different.

Appeal dismissed.

5.4. ITC 1908 – Tax Administration – Understatement penalty

The taxpayer was an investment company that also rendered financial advisory services to Black Economic Empowerment entities in respect of which services it received remuneration.

The taxpayer had submitted its income tax returns in respect of the 2011-14 years of assessment and the aforementioned returns had stated that the taxpayer neither received any income nor had incurred any expenditure during the above tax periods and, in other words, the taxpayer had rendered returns referred to, in tax parlance, as 'nil returns.'

The taxpayer, at the time of the above rendition of the 'nil returns' had already paid provisional tax in respect of the 2011 to 2014 years of assessment in the total amount of R13 777 347,74 and the rendering of the 'nil returns' resulted in a credit balance in the taxpayer's tax account that entitled it to a tax refund and although SARS had the funds in its possession, it was not entitled to the use thereof as the funds were reflected as a credit in the taxpayer's account.

As far as the taxpayer's VAT obligations were concerned, it had neither registered for VAT nor had it rendered any VAT returns for the 2011 to 2014 years of assessment and that was so despite the fact that it was actively trading and was, in the course thereof, charging for VAT.

In that regard the taxpayer had entered into consultancy agreements in terms

whereof it would act as a financial adviser and manager to companies and provide financial advice and would be paid significant fees in respect thereof.

The taxpayer did not dispute the non-rendition of VAT returns and its only contention was that its non-rendition of the VAT returns did not result in any 'prejudice to SARS or the *fiscus*' as envisaged in section 221 of the Tax Administration Act.

SARS subsequently raised VAT assessments in respect of the taxpayer and no objection had been lodged against these assessments.

The taxpayer did not dispute, in respect of income tax, that its returns contained 'an omission' or 'an incorrect statement' within the contemplation of section 221 of the Act and, in respect of the VAT payable, that it was 'in default in rendering the return' as contemplated in section 221 of the Act.

The taxpayer contended, however, that the conceded 'omission' and 'default' did not result in any 'prejudice to SARS or the *fiscus*' as envisaged in section 221 of the Act.

In terms of section 102(2) of the Act, SARS bore the burden of proving the facts upon which it relied for its imposition of an understatement penalty.

At issue in this appeal was SARS' entitlement to levy understatement penalties in accordance with the provisions of section 222(1) of the Act for the relevant years of assessment and, in particular, whether it could be said, in the circumstances of the case, that SARS and/or the *fiscus* had suffered any prejudice as a result of the 'omission' and the 'default' as already described and whether the penalties as levied by SARS fell properly to be increased.

SARS contended that he was entitled to levy penalties as there were understatements as defined in section 221 of the Act in respect of the taxpayer's taxable income and VAT payable for the 2011 to 2014 years of assessment.

SARS had maintained further that the understatement penalties levied by him at the reduced percentages of 25% in respect of the income tax understatement and 50% in respect of the VAT understatement were in all the circumstances of the matter, lenient and thus fell properly to be increased by the court in the exercise of

its discretionary powers as provided for in section 129(3) of the Act.

SARS had initially levied a 100% penalty in respect of both the income tax and the VAT understatements but the taxpayer had objected thereto and consequently he had reduced the penalty from ‘gross negligence’ (100%) to 25% and 50% respectively, being ‘reasonable care not taken when completing the return’ (25%) in respect of the income tax reduction and ‘no reasonable grounds for tax position taken’ (50%) in respect of the VAT understatement penalty.

SARS had contended that SARS had suffered prejudice as a result of the taxpayer’s non-rendition of VAT returns and the misstatements in the income tax returns and that prejudice was in the form of the opportunity cost flowing directly from the non-rendition of VAT returns and the taxpayer’s misstatements in respect of taxable income earned during the 2011 to 2014 years of assessment.

SARS consequently, based on the above, had originally levied penalties in the order of 100% of the income tax and VAT payable in terms of section 223(1)(iv)(3) of the Act on the basis that this was a case where the understatement was brought about by the gross negligence of the taxpayer and the case was a standard one.

SARS was now of the view that the penalties imposed were too lenient and that the court should, in the exercise of its discretion, increase them to 100% in respect of both the income tax and VAT amount payable.

Judge Nkosi-Thomas held the following:

As to whether SARS suffered prejudice

(i) That the uncontroverted evidence before the court was that SARS suffered prejudice in the form of the opportunity cost occasioned by its delayed recovery of the income tax and VAT amounts due to it. Although SARS had the funds in its possession throughout, it was not entitled to the use thereof as the funds were reflected as a credit in the account of the taxpayer and, indeed, the interest that accrued to the funds during the time when SARS had the funds in its possession was for the taxpayer’s account.

(ii) That taxes are a compulsory contribution to the fiscus to finance government activities and are computed at rates established by law and are

the primary source of government income. The funds thus collected by SARS through taxation are, through a Parliamentary budgetary process, allocated to various departments at national, provincial or local government and it is through these allocations that departments secure and use appropriate government money.

(iii) That in casu the taxpayer's provisional tax refund could not form part of the budgetary process as it was held by SARS for the benefit of the taxpayer. Accordingly, although SARS was in possession of the funds, it could not use the funds to fund governmental activities in the manner set out.

(iv) That it was thus difficult to fathom the contention that SARS, and indeed the fiscus, was not prejudiced by the taxpayer's conceded 'omission' and 'default.' The view of the court was that SARS and the fiscus were prejudiced by the taxpayer's actions and that that prejudice included the resource allocation flowing from the taxpayer's aforesaid 'omission' and 'default' as well as opportunity cost to SARS occasioned by its delayed recovery of the income tax and VAT amounts due to it.

(iv) That it followed that SARS had discharged its onus of proving an 'understatement' by the taxpayer of its income tax and VAT within the contemplation of section 221 of the Act.

<u>As to whether SARS should levy a penalty and the quantum thereof</u>

(v) That section 222(1) of the Act provided that in the event of an 'understatement' by a taxpayer, the taxpayer 'must pay,' in addition to the tax payable for the relevant tax period, the understatement penalty and section 222(2) provided that the understatement penalty is the amount resulting from 'the highest applicable understatement penalty percentage, in accordance with the table in section 223', to each shortfall determined under subsections (3) and (4) in relation to each understatement in the return.

(vi) That the question that confronted the court was whether the percentages of 25% and 50% that had been imposed by SARS for income tax and VAT respectively had represented 'the highest applicable understatement

penalty percentage in accordance with the table in section 223' as set out in section 222(2) of the Act while SARS had contended that these percentages fell to be adjusted upwards by the court.

(vii) That, in regard to the income tax penalties, as the taxpayer had made understatements in its tax returns for the tax years in issue, it followed that it 'must pay…the understatement penalty' in accordance with section 222(2) of the Act and SARS was obliged to levy 'the highest applicable understatement penalty percentage in accordance with the table in section 223.'

(ix) That, in the court's view, the highest applicable understatement penalty percentage in accordance with the table in section 223 was the one applicable to 'gross negligence' of a standard type, in respect of which 100% of the shortfall was payable.

(x) That the Supreme Court of Appeal in S v Dhlamini 1988 (2) SA 302 (A) at 308D–E, [1988] 2 All SA 106 (A) at 311, had described gross negligence as including an attitude or state of mind characterised by 'an entire failure to give consideration to the consequences of one's actions, in other words, an attitude of reckless disregard of such consequences.'

(xi) That, accordingly, the conduct of the taxpayer described above amounted to 'gross negligence' and the understatement penalty payable in this regard was 100% of the shortfall, that shortfall being the amount of the assessed taxes in each tax year referred to.

(xii) That, in regard to the VAT penalties, a failure to both register for VAT and to render VAT returns in circumstances where the taxpayer was charging for VAT, constituted behaviour much more serious than 'no reasonable grounds taken for a 'tax position'' and that behaviour ought properly to be characterised as 'gross negligence' of a standard type.

(xiii) That, similarly, the 50% understatement penalty imposed by SARS fell to be increased to 100% in order to accord with the 'gross negligent' character of the taxpayer's understatement.

(xiv) That the question on appeal to this court was not only whether SARS' decision was correct or not, but how this court should exercise its own discretion on the evidence before it and it was correct that the understatement penalties levied by SARS in respect of both the income tax and VAT were unduly lenient.

(xv) That, accordingly, given the gross negligent character of the taxpayer's understatement, the highest applicable understatement penalty was 100% in respect of both the income tax and the VAT understatement.

5.5. Arundel School v Zimbabwe Revenue Authority

The taxpayers, being six private senior schools operating in Zimbabwe in terms of their respective trust deeds.

Some employees of the aforementioned schools had their children enrolled at the schools where they worked or at other schools which had mutual agreements with the school at which they were staff members. In terms of those arrangements, the employees of the schools whose children were enrolled at these schools did not pay the same amount of school fees as non-staff parents whose children were enrolled at the schools. The employees' children were spread across the schools and were enrolled in various classes.

The schools charged their employees between 20% and 25% of the full fees payable *per* child and no taxes were paid on the difference between the 20% and 25% of the fees and the full fees payable at the participating schools for the 2009 and 2010 tax years. The first, second, third and sixth schools charged 20% while the remaining two charged 25%. The fourth school used to charge 3% before it was directed by the Zimbabwe Revenue Authority (ZRA), on 30 November 2009 to charge 25% and it started charging 25% from the third term of 2009.

ZRA contended that the difference between the fees paid by the employee parents to the schools and the full fees payable at the schools was an advantage or a benefit in terms of section 8(1)(*f*)I(vi) of the Income Tax Act [*Chapter 23:06*] to the employee parents arising from their contracts of employment with the schools

which should have been taxed.

ZRA further asserted that the cost of the benefit to the schools in respect of each benefiting child was the same as the cost of every other pupil enrolled at the school and therefore decided to tax the schools on the basis that the advantage or benefit claimed by ZRA was equivalent to the waived amount.

The schools had disputed ZRA's aforementioned contentions.

ZRA raised and issued tax assessments against the schools in terms of par. 10 of the Thirteenth Schedule to the Income Tax Act for taxes which were alleged to be due from the employee parents and which ZRA asserted the schools were obliged but failed to withhold from the incomes of the concerned employee parents.

The schools disputed both the obligation asserted by ZRA and the application of the legislation in the manner invoked by ZRA.

The schools objected to ZRA's tax assessments and ZRA had dismissed their objections.

The schools then appealed unsuccessfully to the Special Court for Income Tax Appeals (see *ITC 1885* (2016) 78 SATC 316) against the decision of the Commissioner-General disallowing their objections.

The schools' contention before the court *a quo* was that the difference between the subsidised school fees paid by children of the schools' employees and the fees paid by full school fee paying students was not taxable in terms of section 8(1)(*f*) of the Income Tax Act because it was not an advantage or benefit.

The court *a quo* had dismissed the schools' appeals holding that the concessionary scheme for the payment of part of the school fees by employees whose children were enrolled at these schools should be included in the gross income of the employees in terms of section 8(1) and section 8(1)(*b*) of the Income Tax Act and should be included in the assessment of pay-as-you-earn.

The court *a quo* held that the subsidised school fees was an advantage or benefit in terms of section 8(1)(*f*)I(*a*) of the Act and it found that the correct assessment had been made in terms of section 8(1)(*f*)I(*a*) of the Act.

The court *a quo*, in respect of the second and third schools, set aside the assessments raised by ZRA and found that the liability of the second and third appellants was not in terms of section 8(1)(*f*) of the Act, but was in terms of the main charging provision of section 8(1) of the Act.

The court *a quo* held that ZRA should include in the gross income the amount waived by the school at which the child of each such employee parent was enrolled before re-assessing the appropriate pay-as-you-earn liability of the second and third schools.

The appeal raised three issues for determination:

- Whether or not the court *a quo* correctly found that the subsidised school fees fell within the ambit of the definition of 'gross income' in terms of sections 8(1) and 8(1)(*b*) of the Income Tax Act and was therefore liable to taxation;
- Whether or not the court *a quo* had correctly found that the subsidised school fees were 'an advantage or benefit' in terms of section 8(1)(*f*)I(*a*) of the Income Tax Act;
- Whether or not the court *a quo* had correctly assessed the calculations of such waived amounts.

The schools contended that the difference between the amount paid by full school fee paying children and the amount paid by the children of parents employed at these schools was not part of the schools' employees' gross income in terms of section 8(1) of the Income Tax Act.

Judge Uchena held the following:

<u>As to whether the subsidised school fees fell within the definition of 'gross income' in terms of ss 8(1) and 8(1)(b) of the Act</u>

(i) That the relevant provisions in the Income Tax Act are wide enough to cover all money and any other property, corporeal or incorporeal, which has an ascertainable monetary value. Non-monetary items which have an ascertainable monetary value are included in the terms of this provision. A

non-monetary item can only escape if it has no ascertainable value. The question which arises is whether the difference between the amount paid by full school fee paying children and the amount paid by the children whose parents are employed at these schools is an incorporeal thing with an ascertainable value?

(ii) That it was obvious that the benefit received by the employees of the schools is an incorporeal thing with an ascertainable value and, as such, the advantage received by the employees of the schools fell within the broad definition of the term 'gross income.'

(iii) That the concessionary rate of school fees which was offered to the schools' employees was income and should have been taxed as the concessionary rate has a value which is taxable in terms of section 8(1) of the Act.

(iv) That the court a quo, therefore, correctly found that the subsidised school fees fell within the definition of 'gross income' in terms of section 8(1) of the Act and was therefore liable to taxation.

(iv) That section 8(1)(b) clearly stated that any amount received or accrued in respect of services rendered or to be rendered, whether due and payable under any contract of employment or service, is liable to taxation. Having accepted that the subsidised fees were an amount in terms of the Act, it was therefore clear that that amount had accrued to the schools' employees because of their contract of employment.

(v) That, therefore, sections 8(1) and 8(1)(b) of the Income Tax Act were wide enough to cover the difference between the concessionary fees and full school fees which accrued to the schools' employees.

(vi) That it was clear that the benefit received by the employees of the schools fell within the broad definition of the term 'gross income' and therefore was subject to taxation.

<u>As to whether the subsidised school fees were 'an advantage or benefit' in terms of section 8(1)(f)I(a) of the Act</u>

(vii) That there was no doubt that the concessionary school fee benefit was granted to the schools' employees by the schools and that the benefit was not being used for the benefit of the schools' business but that of their employees. It was not paid for by the employees but was an advantage or benefit accruing to them by virtue of their being the schools' employees in terms of their contracts of employment and it was therefore part of the employees' taxable income.

(viii) That the employees' right to have their children educated at a concessionary rate constituted incorporeal property as envisaged in section 8(1)(f) of the Act which had a monetary value and it was on that basis that the court found no fault in the judgment of the court a quo that held that the waived amount was an amount equal to the value of an advantage or benefit in respect of employment.

<u>As to whether the court a quo had correctly assessed the calculation of the waived amounts</u>

(ix) That section 8(1)(f)II(b) made it clear that the value of the benefit was to be determined with regard to its cost to the employer and to draw a distinction between variable costs and non-variable costs would be tantamount to reading into the provision what was never intended by the legislature.

(x) That, therefore, the cost to the employee should be computed with regard to the total cost of running the school regardless of the allegation that under the school budget the non-variable costs were covered by the full school fees paying children.

Appeal dismissed with costs.

5.6. ITC 1909 – Deduction, loss incurred for breach of contract

The taxpayer (Z Group (Pty) Ltd) and ABC Corporation ('ABC') had entered into two separate and similar agreements in terms of which the taxpayer would deliver specified tons of coal to ABC during the years 2002 and 2003.

The taxpayer, after it had concluded the aforementioned agreements, and during 2003, sold its business as a going concern to Z Entity (Pty) Ltd ('Z Entity') with an effective date of the transaction being 1 July 2003.

The taxpayer sold its business with its assets and sale contracts including the aforementioned coal sale agreements to Z Entity.

Z Entity subsequently delivered some coal to ABC in terms of the two coal sale agreements and in 2004 a dispute arose between Z Entity and ABC after the effective date referred to above.

The dispute between the parties related to the quality of the coal and Z Entity did not deliver the full amount of coal as stipulated.

ABC had contended that Z Entity had breached the coal sale agreements and that it had suffered a loss as a result of the breach.

The taxpayer and ABC, on 5 September 2007, had concluded a settlement agreement in terms of which the taxpayer paid R90 million to ABC and its managing director.

The taxpayer, at that stage, in 2007, was no longer carrying on the trade of selling coal.

The settlement agreement stated that 'The Defendant is ordered to make payment to the Claimant of the sum of R90 million in full and final settlement of all claims which the Claimant has against the Defendant arising from whatever cause.'

No breakdown or apportionment was provided for in the settlement agreement so that the purpose of the payment could be determined.

The taxpayer's auditor, D, testified that the R90 million that the taxpayer had paid to ABC related to coal that was purchased in 2002 but would only be delivered

later and at that time in 2002 the taxpayer was trading in coal.

ABC had also complained about the quality of the coal and its claim for compensation included an alleged loss for poor quality coal.

A further issue raised by D was that ABC did not consent to the assignment of rights and obligations under the sale of business contract from the taxpayer to Z Entity and therefore the obligations of the taxpayer did not validly pass to Z Entity and that was why the taxpayer accepted liability for ABC's loss.

The taxpayer had claimed a deduction in terms of section 11(*a*) of the Income Tax Act in its return of income for 2007 in respect of the compensation paid by it to ABC and D also contended that the R90 million was an expense in the production of past income.

SARS had raised an additional assessment on the taxpayer concerning the 2007 year of assessment in which it had disallowed and accordingly added back the R90 million that the taxpayer had previously claimed as an expense or loss incurred in the production of income.

The issue for determination before the court was whether the taxpayer was entitled to a deduction for the compensation that it had paid or loss that it had suffered in the amount of R90 million and, in particular, whether the taxpayer was carrying on the trade of selling coal when it paid the amount of R90 million and whether the expense had been incurred in the production of income or for the purpose of trade.

Judge Allie held the following:

(i) That the *onus* was on the taxpayer to show, on a balance of probabilities, that the expense in issue had been incurred in the production of income or for the purpose of trade and that its disallowance by SARS was incorrect.

(ii) That in *Caltex Oil (SA) Ltd v SIR* 37 SATC 1 it was held that it was in the tax year in which the liability for the expenditure was actually incurred (if paid in a subsequent year) that the expenditure is actually incurred for the purpose of section 11(*a*) of the Income Tax Act 58 of 1962 and, *in casu*, it was the 2007 year of assessment in which the expense of R90 million had been incurred, i.e. the year in which the settlement agreement had been

entered into, and, at that stage, the taxpayer was no longer trading in coal.

(iii) That if the taxpayer had been trading in horses or wine in the 2007 tax year, the expense incurred by it of compensating Z entity for reneging on the contracts of sale, supply and delivery of coal to ABC, had no bearing on the purpose of the trade that the taxpayer had been engaged in by 2007.

(iv) That the taxpayer's argument that the expense in issue was a contingent liability that related to the production of income in the 2003 year of assessment was not accompanied by persuasive authority that lent support to its contention that the provisions of the sale of business agreement proved that the parties had contemplated future reckless business decisions which would cause the taxpayer to compensate purchasers of its product and that that would be an instance of a contingent liability.

(iv) That the basis of ABC's claim clearly involved the deliberate and conscious decision of the taxpayer's managing director, who was also Z Entity's managing director, to cause Z Entity to breach the coal agreement with ABC.

(v) That the taxpayer's managing director proceeded to make a further decision to compensate ABC and its managing director on behalf of the taxpayer even though Z Entity had assumed the obligation to supply the coal and had accordingly reneged on its obligation to do so.

(vi) That the taxpayer had sought to rely on the lack of express consent by ABC to the assignment of their contracts to Z Entity as a reason for it accepting liability to ABC. No correspondence between ABC and the taxpayer was provided to support the contention that ABC held the taxpayer liable because it did not consent to the assignment of the contracts.

(vii) That should the court assume, in favour of the taxpayer, that ABC did not consent to an assignment to Z Entity of the rights and obligations under its sale contracts, *inter se*, between the taxpayer and Z Entity, the latter was deemed to have received the risk and benefits of the sale contracts in terms of clause 12.3 thereof and, accordingly, the taxpayer was under no lawful obligation to assume liability to ABC for the breach nor to accept ABC's claim against it.

(ix) That, accordingly, the liability which gave rise to the expenditure in issue had not been incurred during the time when the taxpayer was still trading in coal and there can be no doubt that no actual liability on the part of the taxpayer towards ABC occasioned by a breach of the contract had arisen as at the effective date of the sale of business agreement.

(x) That, as with most sale contracts, there was an obligation to deliver coal to ABC and willful failure to deliver could give rise to liability for damages but that did not constitute a contingent liability in circumstances where no willful breach nor dispute between ABC and the taxpayer had arisen nor had it been contemplated as a contingent liability that the taxpayer would remain liable after the effective date when they had concluded the sale of business agreement.

(xi) That the taxpayer's argument that a contingent liability encompasses any potential liability irrespective of whether a claim existed at the time when the contract became effective was clearly untenable and did not accord with the *ratio* in *CIR* v *Golden Dumps (Pty) Ltd* 55 SATC 198.

(xii) That the clear, plain and unambiguous intention of the legislature in the use of the words contained in section 11(*a*) of the Act was to provide for a deduction of expenses that are necessary or essential or in some close manner required to enable the taxpayer to produce the income from which it sought to make the deduction.

(xiii) That the taxpayer's evidence was silent on the explicit connection between profits derived from the sale of coal and Z Entity's decision to renege on its agreement with ABC. Moreover, the legislature clearly did not contemplate that any expense incurred, however remote it may be to the conduct of trade, ought to be deductible.

(xiv) That, accordingly, the taxpayer had failed to prove, on a balance of probabilities, that the R90 million expended by it had been an expense in the production of its income.

(xv) That, further, SARS' imposition of section 89*quat* interest was confirmed

and it was noted that the court had a discretion to confirm or send back for reconsideration, SARS' decision concerning interest and the court was not required to review SARS' decision under section 89*quat* but must consider the imposition of interest *de novo*.

(xvi) That, in regard to costs, the court ordered the taxpayer to pay the costs, including the costs of two counsel, on the ground that the taxpayer had no reasonable grounds for persisting with the view that the expense in issue was deductible in terms of section 11(*a*).

The assessment made in respect of the 2007 year of assessment was confirmed.

5.7. ITC 1910 – Tax avoidance

The taxpayer was a juristic person and was registered and incorporated as a company in South Africa and carried on business in the petrochemical industry.

The taxpayer had some of its subsidiaries in foreign jurisdictions and its business activities included the importation and refinement of crude oil.

X Ltd had held all the shares of the taxpayer prior to 1 December 1997 in XYZ and X International Holdings (Pty) Ltd, 'XIH' and XIH held all the shares of X Trading International Ltd ('XTI'), a company incorporated in the Isle of Man ('IOM').

During the relevant years XYZ had the following subsidiaries in which it owned all of the shares: XX International Ltd ('XYZIL', resident in the Isle of Man) and X International Services Ltd ('XIXL', resident in the United Kingdom). The shares in XIXL were owned by XIH until 2004 when they were transferred to XYZ.

XYZ and XTI had concluded a written agreement on 28 September 1998 ('Original Supply Agreement') whereby XTI undertook to supply crude oil to XYZ (previously purchased by X from XTI) and the crude oil was to be delivered by XTI either at Durban or in the Port of Durban and risk and ownership in the crude oil passed to XYZ at the time the crude oil passed the ship's manifold at discharge port.

On 1 December 2001 XTI and XIXL signed a new agreement ('First XTI Supply Agreement') for the supply of X's crude oil requirements. The 'Effective Date' of the

agreement was 1 July 2001 and it was to continue to be of full force and effect until 30 June 2003.

In terms of the aforesaid agreement XTI undertook to supply crude oil to XIXL and XIXL undertook to buy such crude oil from XTI according to the terms and conditions contained in the agreement.

The destination of the crude oil to be delivered to XIXL was to be Durban and all risk in the crude oil purchased by XIXL was to pass to XIXL at the loading vessel's permanent hose connection points at the load port.

In April 2004 XIXL and XYZ signed a further written document ('XIXL Supply Agreement') in terms of which XIXL undertook to supply crude oil to XYZ and XYZ undertook to buy such crude oil from XIXL according to the terms and conditions contained in the agreement.

The agreement further provided that all crude oil purchased by XYZ would be delivered by XTI either at Durban or in the Port of Durban and XIXL would assume all risks and costs associated with shipping the crude oil and for which it would levy a fixed price per barrel.

In October 2004 XIXL, XTI and XYZIL signed an 'Assignment Agreement' whereby XTI assigned all of its rights, duties and obligations under the oil agreement to XYZIL and XYZIL accepted all of XTI's rights and assumed all of XTI's duties and obligations under the oil agreement.

The taxpayer, because of the implementation of the abovementioned supply agreements, had excluded the amounts received or accrued to XYZIL, a Controlled Foreign Company ('CFC'), from the sales of crude oil, in breach of the provisions of section 9D of the Income Tax Act.

SARS had issued additional assessments against the taxpayer for the 2005, 2006 and 2007 years of assessment and the assessed amounts were included in the taxable income of the taxpayer.

Moreover, additional tax was levied in terms of section 76 of the Income Tax Act as well as interest in terms of section 89*quat* of the Act.

SARS contended, in essence, that XIXL had been interposed as a party in the supply chain in 2001 to divert the ownership of crude oil in the original supply chain and hence divert profit from XTI and subsequently XYZIL and that it was the intention of the taxpayer and its group of companies that the sale of crude oil would remain between XYZIL and XYZ and the interposition of XIXL provided a tax benefit to the taxpayer's group. The benefit was secured by virtue of XYZIL being resident in the Isle of Man and this continued after the introduction of the residence-based taxation regime, as the Group continued to pay 0% tax on the profits of XYZIL both in the Isle of Man and in South Africa.

SARS, in the alternative, contended in its grounds of assessment that the taxpayer's structure constituted a transaction, operation or scheme as contemplated in section 103(1) of the Income Tax Act as the structure had the effect of avoiding liability for the payment of tax imposed under the Act.

SARS' case, in summary, was based on the principle of substance over form, in which event the provisions of section 9D of the Act would be applicable and, alternatively, SARS' case was based on the application of section 103 of the Act.

The taxpayer contended that the substance of the relevant agreements did not differ from their form and accordingly denied that in substance the amounts which were received by or accrued to XYZIL from sales of crude oil were from sales of crude oil by XYZIL to X Oil.

The taxpayer contended that both in form and substance the relevant amounts were received by or had accrued to XYZIL from the sale of crude oil by XYZIL to XIXL and, for that reason, it was argued that those amounts were excluded from the net income of XYZIL in terms of section 9D(9)(*b*) of the Act on the basis that they were not attributable to amounts derived from the sale of goods by XYZIL to a connected person who was a resident.

The taxpayer, in the alternative, contended that even if the relevant amounts were attributable to amounts derived by XYZIL from sales of goods by XYZIL to any connected person in relation to XYZIL, which was a resident by virtue of the provisions of par. (A) of section 9D(9)(*b*), (ii)(*aa*), such amounts were not included in the net income of XYZIL, for the purposes of section 9D of the Act.

The taxpayer contended further that the requirements of section 103(1) of the Act and the requirements of section 89*quat* of the Act had not been satisfied and it had not become liable for penalties in terms of section 76 of the Act and contended in the alternative that SARS should have remitted such penalties in terms of section 76(2)(*a*) of the Act.

The court had to consider whether the substance of the relevant agreements differed from their form in the manner contended for by SARS and, if so, whether the relevant amounts were excluded from XYZIL's net income, for the purposes of section 9D, on the basis that the requirements of par. (A) of section 9D(9)(*b*)(ii)(*aa*) had been satisfied.

The court also had to consider whether the taxpayer should be liable for penalties in terms of section 76 of the Act and interest in terms of section 89*quat* of the Act.

Judge Mali held the following:

(i) That this matter concerned the analysis of supply agreements entered into between the taxpayer and some of its foreign subsidiaries and brought to the fore, *inter alia*, the application of the South African developing fiscal legal principles, namely, residence based taxation, section 9D of the Income Tax Act 58 of 1962 and other established principles of tax law, such as anti-tax avoidance provisions and substance over form and tax avoidance is the use of legal methods to modify a taxpayer's financial situation in order to reduce the amount of tax that is payable.

(ii) That the principle enunciated in the several authorities quoted stipulated that in order to treat a transaction as simulated or a sham, it was necessary to find that there was dishonesty. The parties did not intend the transaction to have effect in accordance with its terms but intended to disguise the transaction. The transaction should be intended to deceive by concealing what the real agreement or transaction between the parties is.

(iii) That before determining whether the transaction is simulated the court is enjoined to follow the true position by examining the transaction as a whole. Whilst the court agreed that if the transaction is genuine then it is not simulated, it did not understand that the enquiry ends with the interplay of

'genuine is equal to no simulation.' The court's view was that even if the agreements are considered to be genuine, the matter cannot be closed without a thorough examination of the relevant agreements. The court should follow the entire chain and its appreciation of the breakdown should be as follows: (i) look at all surrounding circumstances (ii) any unusual features of the transaction and the manner in which the parties intend to implement it (iii) of great importance in looking at the features will be the income tax consequences of the transaction.

(iv) That, from the judgment of *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC and Others* [2014] 2 All SA 654 (SCA) the court did not discern any requirement for SARS to plead fraud and what was necessary was the scrutiny and close examination of the transaction by the court.

(iv) That in determining a matter regarding the principle of substance over form, the well-established law is that the court should conduct the factual enquiry and is enjoined to establish the actual intention of the contracting parties. A disguised transaction, as stated by the court in *CCE v Randles Brothers and Hudson Ltd* 33 SATC 48, is in essence a dishonest transaction: dishonest, inasmuch as the parties to it do not really intend it to have, *inter partes*, the legal effect which its terms convey to the outside world. The purpose of the disguise is to deceive by concealing what is the real agreement or transaction between the parties. The parties wish to hide the fact that their real agreement or transaction falls within the prohibition or is subject to the tax, and therefore they dress it up in a guise which conveys the impression that it is outside of the prohibition or not subject to the tax. Such a transaction is said to be *in fraudem legis*, and is interpreted by the courts in accordance with what is found to be the real agreement or transaction between the parties.

(v) That almost all tax jurisdictions are desirous to lay their hands on taxes arising from profits belonging to their residents. Even developed countries are concerned with the rise of sophisticated and complex tax avoidance schemes resulting in tax base erosion and the same can be said for South Africa.

(vi) That section 102(1)(*a*) and (*f*) of the Tax Administration Act 28 of 2011 provides that a taxpayer bears the burden of proving that an amount, transaction, event or item is exempt or otherwise not taxable. In the present case the taxpayer bears the burden of establishing that the agreement is as contended for by it and thus proving that the assessed amounts by SARS are not taxable.

(vii) That it was highly probable that the actions of the taxpayer group were not commercially driven and the court could not accept the evidence before it that the utilisation of XIXL was a commercial intervention and stated that the relevant witnesses were both not truthful, were evasive and denied the obvious. The court's findings were based on the examination of the agreement coupled with the surrounding circumstances as enjoined by the law regulating the interpretation of agreements.

(ix) That a key circumstance relating to the impugned agreements was that residence-based taxation came into effect in 2001 and the taxpayer's group structure was reviewed around the same period. The taxpayer's witnesses had failed to persuade the court as to the coincidence of the great panic in reviewing the structure with the introduction of residence-based taxation.

(x) That the court could not help but conclude that in the circumstances, the interposition of XIXL was found convenient by the taxpayer to avoid residence-based tax legislation which would apply to the group with effect from 1 June 2001.

(xi) That from the evidence it transpired that XIXL did not genuinely perform oil trading functions because little or no risk at all was attributed to XIXL. This is unusual in the business environment. XIXL did not truly buy and sell crude oil and XIXL was not involved in crude oil trading.

(xii) That there was compelling evidence that XIXL's requirements for crude oil were in fact XYZ's requirements and everything was predetermined, including pricing structure and it was business as before the introduction of XIXL.

(xiii) That there were several material inconsistencies alluding to the business of

XIXL which included the following: in a management document XIXL was described as providing services and not as trading and as not bearing any real risk in respect of the crude oil in respect of which it provided shipping services.

(xiv) That it was apparent that the true position was that XIXL was providing services and did not bear significant risk in respect of crude oil – a very unusual feature for a purported trader in crude oil and, therefore, the court concluded that the features and the implementation of the transaction did not serve any real commercial justification.

(xv) That, moreover, the relevant International Commercial Terms ('INCO') did not support the taxpayer's case and the XYZIL/XIXL agreement did not have the provisions which would be expected in Free on Board ('FOB') contracts and there was no physical delivery as envisaged by the normal FOB.

(xvi) That the question was whether the substance of the relevant agreements differed from form. The interposition of XIXL and the separate reading of 'back-to-back' agreements took XIXL out of the equation. The original commercial purpose was maintained by achieving the objectives of XTI/XYZIL selling the crude oil to XYZ and, in particular, ensuring that the material rights and obligation to XTI/XYZIL and XYZ were the same as those that existed under the Original Agreement and, again, this demonstrated that XIXL's interposition in the value chain raised further questions about its commercial justification. The 'daisy chain' nature of the oil supply chain referred to in the expert's testimony also demonstrated how the interposition of XIXL between the seller (XYZIL) and the buyer (XYZ) was artificial and did not serve any real commercial purpose.

(xvii) That, accordingly, the surrounding circumstances and implementation of the uncharacteristic features of the transaction, pointed to none other than disguised contracts and the court could only read one thing that was not expressed as it was: tax avoidance. Based on the evidence the court concluded that the purpose of the relevant supply agreements was to avoid

the anticipated tax which would accrue to XYZIL, a CFC, if it sold the crude oil directly to XYZ.

(xviii) That, therefore, SARS was correct in including the assessed amounts in determination of XYZIL's net income for the purposes of section 9D of the Act and, in the circumstances, it was unnecessary to consider the alternative ground of assessment, section 103(1) of the Act.

(xix) That, further, the relevant amounts were not excluded from XYZIL's net income, for the purposes of section 9D, on the basis that the requirements of par. (A) of section 9D(9)(*b*)(ii)(*aa*) had been satisfied, because of the findings referred to above that XIXL's interposition was a sham.

Appeal dismissed and the assessments for the 2005, 2006 and 2007 tax years as well as interest and penalties were confirmed.

5.8. Lion Match Company (Pty) Ltd v C:SARS

Lion Match, during the 2008 year of assessment, had disposed of its entire shareholding in the Kimberly Clark Group and the market value ascribed by Lion March to the shares as at 1 October 2001 was adopted as the base cost in determining its taxable capital gain.

However, in assessing Lion Match to tax by way of an additional assessment on 30 April 2013, SARS had adjusted the base cost of the value of the shares, which resulted in an increase in Lion Match's taxable capital gain.

Lion Match had objected to the adjustment, which was disallowed by SARS and Lion Match then noted an appeal against the disallowance of its objection to the Durban Tax Court.

SARS, in opposing Lion Match's appeal to the Tax Court, had filed its statement of grounds of appeal in terms of Rule 31 of the Rules of the Tax Court promulgated under section 103 of the Tax Administration Act.

Lion Match, rather than avail itself of the opportunity to respond with a statement of its own in terms of Rule 32, launched an application in the Tax Court to set aside

SARS' Rule 31 statement styled 'Appellant's notice of application in terms of Tax Court Rule 31(3) issued in terms of the provisions of the Tax Administration Act.

Lion Match had thereby asserted that Lion Match had included in its statement 'a ground that constitutes a novation of the whole of the factual or the legal basis of the disputed assessment issued on 30 April 2013 and sought an order from the Tax Court setting aside the statement of grounds of assessment dated 14 August 2015 as invalid for want of compliance with the provisions of Tax Court Rule 31(3).

The Tax Court (*per* Moodley J) had dismissed the application, but had granted leave to Lion Match to appeal to the Supreme Court of Appeal.

The issue before the court on appeal was whether the appeal should be dismissed on the ground that the order of the Tax Court was not appealable.

Judge Ponnan held the following:

(i) That in embarking upon the enquiry as to whether the order of the Tax Court was appealable, the question was not whether the decision of the Tax Court, if wrong, could be corrected on appeal. The real question was whether the decision could be corrected 'forthwith and independently of the outcome of the main proceedings' or whether Lion Match was constrained to await the outcome of the main proceedings before this decision of the Tax Court could be attacked as one of the grounds of appeal and, in effect, the question was whether the particular decision may be placed before a court of appeal in isolation, and before the proceedings have run their full course.

(ii) That the Tax Court was constituted in terms of the Tax Administration Act and, as such, the scope of its jurisdiction, its powers and the ambit of any right of appeal from its decisions were defined in the Act.

(iii) That, according to section 117 of the Act, the Tax Court has jurisdiction over appeals lodged under section 107 and in terms of section 107(1) 'a taxpayer objecting to an assessment or 'decision' may appeal against the assessment or 'decision' to the Tax Court.' 'Decision' is defined in s 101 as 'a decision referred to in s 104(2)' and three decisions were referred to in s 104(2).

(iv) That, furthermore, section 129 of the Act provided that in the case of an assessment or 'decision' under appeal or an application in a procedural matter referred to in section 117(3) of the Act, the Tax Court may (*a*) confirm the assessment or 'decision'; (*b*) order the assessment or 'decision' to be altered or (*c*) refer the assessment back to SARS for further examination and assessment.

(iv) That in determining whether the decision of the Tax Court was appealable under section 129, the question was whether the decision was one contemplated by s 104(2) of the Act and in this case it plainly was not.

(v) That, however, Lion Match submitted further that the application which had served before the Tax Court had to be likened to an exception rather than an application to strike out in terms of Rule 6(15) of the Uniform Rules of Court and, accordingly, the Tax Court in dismissing the application had spoken the final word on the issue of its jurisdiction and the order was for that reason appealable.

(vi) That it was trite that a dismissal of an exception (save an exception to the jurisdiction of the court) presented and argued as nothing other than an exception is not appealable. Jurisdictional challenges should be raised either by exception or special plea depending on the grounds upon which the challenge arises. In either event the issue must necessarily be disposed of first because upon it depends the power of the court to make any further order.

(vii) That, *in casu*, the want of jurisdiction on the part of the Tax Court was not raised by way of exception or special plea and it was neither presented nor argued as an exception to jurisdiction. Instead, it was only tangentially raised as part of what Lion Match conceded was a rather novel application to the Tax Court and, not having been squarely raised, the Tax Court did not as such pronounce on the issue.

(ix) That it followed, absent a decision by the Tax Court on the question of jurisdiction, that an appeal could hardly avail Lion Match as an appeal lies not against the reasoning, but the substantive order of a court.

(x) That, accordingly, the decision of the Tax Court was not appealable and in the result the appeal fell to be struck from the roll with costs, such costs to include those of two counsel.

5.9. C:SARS v Executers Estate Late Sidney Ellerine

The estate of the late Sidney Ellerine ('deceased') held certain issued preference shares and they formed part of the share capital of Sidney Ellerine Trust (Pty) Ltd ('the company') which, in total, consisted of 600 ordinary shares of R1 each and 112 000 7% redeemable non-cumulative preference shares of R1 each.

The deceased held all of the redeemable preference shares issued by the company and the registered and beneficial owners of the ordinary shares were four family trusts.

The preference and ordinary shares enjoyed one vote for each share in general meetings of shareholders so that the deceased held the overwhelming majority (99,47%) of the voting rights at general meetings of the company.

SARS was required in terms of par. 40(1) of the Eighth Schedule to the Income Tax Act to make a determination of the capital gains resulting from the deemed disposal of the deceased's preference shares.

Paragraph 40(1) of the Eighth Schedule provided that 'a deceased person is treated as having disposed of his/her assets . . . for an amount received or accrued equal to the market value of those shares at the date of the person's death.'

The market value of the shares in a company, not listed on a recognised exchange, must be determined in terms of par. 31(3) of the Eighth Schedule as the value equal to the price that could have been obtained upon the sale of the shares between a willing buyer and a willing seller dealing at arm's length in an open market.

SARS had assessed the Estate's liability for capital gain, determining that the deceased was entitled, by using his voting power, to convert these preference shares to ordinary shares and SARS had assessed the value of the preference

shares in the amount of R563 376 418, on the basis that the shares had represented 99,47% of the share capital of the company and thus should be valued at 99,47% of the value of the company.

SARS had contended that the nominal value of the 112 000 preference shares did not reflect the market value of the shares, as the voting rights attached to the shares entitled the deceased to convert his preference shares into ordinary shares at any stage after 9 May 2006, and this by virtue of Article 7.1.10 of the Articles adopted on 9 May 2006 by the company, and notwithstanding the provisions of Special Condition 5.8.

The Estate had, by contrast, contended that the value of the preference shares as at the date of the deceased's death was equal to the par value of the shares, namely R112 000.

The Estate contended that the value of the preference shares must be determined on the basis that the holder was precluded from converting these shares to ordinary shares without obtaining the prior written approval of at least 75% of the ordinary shareholders and at least 75% of the holders of each class of shares in Eric Ellerine Trust (Pty) Ltd (EET), a company controlled by the deceased's brother Eric Ellerine.

The Estate's contention was based firstly upon special condition 5.8 read with Article 34 of the company's Memorandum and Articles of Association and, secondly, on a reading of Article 4.2.

The Estate submitted that the terms of special condition 5.8 of the Memorandum read together with Articles 4.2 and 34 of the Articles of Association of the company precluded the deceased from converting these preference shares to ordinary shares, without the voting support of at least 75% of the ordinary shareholders: hence the preference shares should be valued at their fair value of R1 *per* share.

The Estate had accepted that, apart from the aforementioned arguments, the deceased would have been able to convert his preference shares into ordinary shares in terms of Article 7.1.10 of the company's Memorandum and Articles of Association.

The dispute before the court, concerning the value of the preference shares, thus necessitated an examination of the relevant and key provisions of the company's governance structure, i.e. its articles as well as special condition 5.8.

In the court *a quo*, the Gauteng Tax Court (per Victor J), the only issue before the court was whether the rights that attached to the preference shares and which entitled the holder thereof to convert them should be taken into account in the determination of the market value.

The court *a quo*, after interpreting the relevant provisions of the Memorandum and Articles of Association, concluded that, on the date of his death, the deceased was not entitled to convert the preference shares to ordinary shares, in that, at least 75% of the holders of each class of shares had to agree to the conversion.

The court held that, contrary to special condition 5.8 of the Memorandum, the conversion would result in an amendment to the terms applicable to these preference shares as provided for in Article 34 of the Articles of Association and consequently their rights. However, without the prior written approval of at least 75% of the holders of each class of shares, Article 34 could not be amended and it was common cause that no such approval had been obtained.

The court *a quo* held accordingly that the deceased at the time of his death was not entitled to convert the preference shares to ordinary shares and the preference shares had to be valued accordingly for the purposes of par. 40 read together with par. 31(3) of the Eighth Schedule to the Income Tax Act 58 of 1962.

The dispute before the Supreme Court of Appeal turned on the resolution to two questions:

- Could the holder of the deceased's preference shares convert these shares into ordinary shares without an amendment to Article 34 of the Articles of Association, which, when read with special condition 5.8, required the written approval of 75% of the holders of each class of shares in the issued share capital of the company;
- Whether, in terms of Article 4.2, conversion of the deceased's preference shares to ordinary shares could take place without the approval of 75% of

the holders of the ordinary shares.

Article 34 provided that a number of rights, privileges and conditions attached to the preference shares in issue, including that they conferred the right to a preferential dividend at the rate of 7% *per annum* on the capital, paid out of the profits of the company resolved to be distributed in respect of each financial year and a preferential right to repayment of capital paid but with no further rights to participate in or receive assets or capital. It also provided that holders of the preference shares would have the right to attend and vote at all meetings of the company and to exercise one vote *per* share.

In regard to the rights provided for in Article 34, these, in terms of special condition 5.8, could only be amended by way of the passing and registration of a special resolution and such special resolution would be of no force or effect unless the prior written approval of at least 75% of the holders of each class of shares in the issued share capital of each of the company and Eric Ellerine Trust (Pty) Ltd.

The determination of whether a conversion of preference shares to ordinary shares could take place without the consent of ordinary shareholders was further affected by Article 4.2 which permitted the variation of any rights attaching to a share with the consent in writing of the holders of 75% of the shares of that class of share.

Article 7.1.10, which specifically dealt with the conversion of shares, provided that the company may from time to time by special resolution convert any shares in the capital of the company to shares of a different class and in particular convert ordinary shares or preference shares to redeemable preference shares.

Judge Davis held the following:

(i) That SARS was required, in terms of the Eighth Schedule to the Act, to make a determination of the capital gains resulting from the deemed disposal of the deceased's preference shares and in terms of par. 40(1) of the Eighth Schedule 'a deceased person is treated as having disposed of his/her assets . . . for an amount received or accrued equal to the market value of those shares at the date of the person's death.' The market value of the shares in a company, not listed on a recognised exchange, must be

determined as the value equal to the price that could have been obtained upon the sale of the shares between a willing buyer and a willing seller dealing at arm's length in an open market.

(ii) That in regard to the question whether special condition 5.8 applied to a conversion of preference shares to ordinary shares, on a plain reading of the words 'articles 29 and 34 . . . may be amended . . .' there was no need to amend Article 34 in order for preference shares issued by the company to be converted to ordinary shares and on this reading special condition 5.8 would not be engaged by such a conversion and the restrictions it embodied would not apply to it.

(iii) That the Estate's argument was based on an interpretation of the purpose of special condition 5.8 as protecting the shareholders of 'each class of shares' (which included both the ordinary shares and the preference shares), from amendments to the terms of the preference shares which might impact upon their rights as shareholders and a conversion of the preference shares to ordinary shares would, on this argument, alter the 'rights', privilege and conditions of the deceased's preference shares as provided for in Article 34 and hence Article 34 would have been amended.

(iv) That, whatever debate may be developed with regard to the context urged upon this court by the Estate, 'consideration must be given to the language used in the light of the ordinary rules of grammar and syntax' (*Natal Joint Municipal Pension Fund* v *Endumeni Municipality* 2012 (4) SA 593 (SCA) at para 18). While the intention of the speaker is a vital component of the interpretive inquiry, the basic unit of meaning remains the sentence employed.

(iv) That in the present case the sentence in Article 34 which commences 'the Preference Shares shall be subject to the following rights privileges and conditions', refers to the preference shares and not to a particular holder of these preference shares. To the extent that there may be any doubt about this construction, Article 34.6 makes it clear that the entire article concerns the rights attached to the preference shares as opposed to the rights of a particular holder thereof. In particular where it provides: 'no further shares

ranking in priority to or *pari passu* with the preference shares shall at any time be created without the consent or sanction of the holders of such last preference shares which may be issued and outstanding given in accordance with Article 4.2 unless such further shares be created and issued for the purpose of redeeming out of the proceeds of the issue thereof the preference shares mentioned in this Article 34 or such of the said shares as shall for the time being be issued and outstanding.'

(v) That any interpretation regarding a company's articles must be located within the context of the nature of articles of association which confer rights or impose obligations on persons who are members. There is, in short, a recognised distinction between contracts made by a company with members in their private capacity and those made in their capacity as members. The Estate appears to contend that without any clear language nor authority to support its argument, a contract was concluded between the company and the deceased in his personal capacity but there was no foundation for this submission.

(vi) That, in regard to the application of Article 4.2, the Estate contended that, if the deceased's preference shares were converted to ordinary shares, the rights attaching to the existing ordinary shares would be varied as a consequence thereof and the variation for which it contended was a drastic drop in the value of those shares. For this reason Article 4.2 would be of application and hence the conversion would require the approval of 75% of the holders of the ordinary shares.

(vii) That English law appeared to support the view that a variation of rights occurred when the rights which attached to the shares were varied and not when they become commercially less valuable. Where additional preference shares and ordinary shares had been issued, it was held that the rights of preference shareholders had not been varied. When the voting power of certain ordinary shareholders had been diminished as a result of subdivision of other ordinary shares it was held that there had been no variation of rights.

(ix) That in the present case the deceased, through the preference shares,

enjoyed sufficient voting power to ensure a conversion of the preference shares to ordinary shares. While the voting rights of the respective class of shareholders would not have changed, by means of the conversion, the value of the existing issued ordinary shares would have declined in value by way of the increased number of the ordinary shares pursuant to the conversion. However, to fall under the scope of rights being 'varied' it would then have been necessary to interpret the phrase to mean that the shares of the ordinary shareholders were now commercially less valuable. The balance of the voting power would not be changed nor would there be any alteration of the rights, privileges and conditions attaching the ordinary shares as a class.

(x) That a further problem which confronted the Estate's argument was the express wording of Article 7.1.10 which, as was clear from the text thereof, provided that any class of shares, by special resolution, could be converted to shares of a different class, absent any other provision in the articles to the contrary.

(xi) That it was clear that the deceased, by virtue of holding the overwhelming majority vote, could have converted the preference shares to ordinary shares. Article 7.1.10 was not qualified by a reference to Article 4.2, both of which were part of the original articles of the company. Had it been intended to impose a qualification upon the position as set out in Article 7.1.10, express language would have been required to make this position clear.

(xii) That the express meaning given to Article 7.1.10 found further support in that the overall consequence of these two articles was a congruence with the distinction between an effect on rights, as opposed to a consequence of a diminished commercial value. Article 4.2 dealt with the former, while a conversion to ordinary shares in terms of Article 7.1.10 catered for a situation where only the latter result might follow and the result was that the argument based on Article 4.2 failed.

(xiii) That, accordingly, the deceased was entitled, on the date of his death, to

convert the preference shares to ordinary shares and the preference shares must be valued, for the purposes of par. 40 read with par. 31(3) of the Eighth Schedule to the Income Tax Act 58 of 1962 on this basis.

Appeal upheld with costs, including the costs of two counsel.

The Commissioner's assessment of the value of the preference shares in the amount of R563 376 418 was upheld.

5.10. Marshall No and others v C:SARS

In this matter the Constitutional Court considered an application for leave to appeal against a decision of the Supreme Court of Appeal (*C: SARS v Marshall* NO 79 SATC 49) on the proper interpretation of sections 8(5) and 11(2)(*n*) of the Value-Added Tax Act.

The effect of the Supreme Court of Appeal decision was that the South African Red Cross Air Mercy Service Trust (the Trust) was not exempt from paying VAT on payments that it received for actual services that it rendered to provincial health departments.

In the course of coming to her conclusion on the proper interpretation of the relevant sections of the Act, Dambuza JA, writing for a unanimous court, referred to Interpretation Notes issued by the South African Revenue Service on 8 February 2013, setting out the VAT treatment of public authorities before and after April 2005.

She commented:

> 'These Interpretation Notes, though not binding on the courts or a taxpayer, constitute persuasive explanations in relation to the interpretation and application of the statutory provision in question. *Interpretation Note 39* has been in circulation for years and has not been brought into contention until now.' (SCA Judgment at para 33)

The Note accorded with the interpretation she gave to the relevant sections of the Act.

The parties were invited to file written submissions on the extent to which a court may consider or defer to an administrative body's interpretation of legislation, such as the *Interpretation Note*, and whether the approach of the Supreme Court of Appeal was in accordance with this.

The Trust contended that no consideration should have been given to the Interpretation Note as, once a dispute arises, the courts must independently determine the meaning of the legislation. To consider the Interpretation Notes as legally relevant to the proper interpretation of legislation would offend sections 9 and 34 of the Constitution in that it would give rise to unequal treatment of the litigating parties and fly in the face of the right to a fair hearing.

In addition, the Trust argued that reliance on the *Interpretation Note* would offend the interpretative anti-taxation (*contra fiscum*) rule which indicates that, in cases of ambiguity, a taxation-imposing provision should be interpreted in favour of the taxpayer and against the *fiscus* or tax-collecting authorities. In addition, the Trust argued that the *Interpretation Note* was, in reality, inadmissible opinion evidence; was inconsistent with the analogous principle that the content of a regulation made under powers derived from a statute may not be relied upon as an aid to the construction of the statute itself; and was a relic of an outdated approach to interpretation, namely to seek to ascertain the subjective intention of the legislature rather than to adopt the proper purposive interpretation, which is concerned with the objective purpose of the legislation.

The Commissioner for SARS submitted that a court may have regard to an administrative body's interpretation of legislation only to the extent that this interpretation constitutes evidence that it has been interpreted in a consistent way for a substantial period of time by those responsible for its administration, in order to tip the balance in the case of marginal statutory interpretation. The Supreme Court of Appeal had first interpreted the relevant provisions independently of the *Interpretation Note* and its reference to it only served to confirm its interpretation.

Judge Froneman held the following:

(i) That in the Supreme Court of Appeal decision in *C: SARS* v *Bosch and Another* 77 SATC 61 it was stated in par. 17:

> 'There is authority that in any marginal question of statutory interpretation, evidence that it has been interpreted in a consistent way for a substantial period of time by those responsible for the administration of the legislation is admissible and may be relevant to tip the balance in favour of that interpretation. This is entirely consistent with the approach to statutory interpretation that examines the words in context and seeks to determine the meaning that should reasonably be placed upon those words. The conduct of those who administer the legislation provides clear evidence of how reasonable persons in their position would understand and construe the provision in question. As such it would be a valuable pointer to the correct interpretation. In the present case the clear evidence that for at least eight years the revenue authorities accepted that . . . fortifies the taxpayers' contentions.'

(ii) That the *Bosch* case illustrates that evidence of the interpretive practice need not necessarily conflict with the *contra fiscum* rule, but that in all other respects, it accorded with the approach taken by the Supreme Court of Appeal in this case.

(iii) That, however, the court posed the question: Is there any reason to re-examine an approach referred to with apparent approval almost a century ago in *Rex* v *Detody* 1926 AD 126 and applied in varying degrees ever since? The court responded: 'I think so.'

(iv) That in the *Detody* case it was made clear that what was at stake was ascertaining the intention of the legislature and that some weight must be accorded to custom in the interpretation of ambiguous legislation.

(iv) That the rule thus originated in the context of legislative supremacy where statutory interpretation was aimed at ascertaining the intention of the legislature. In that particular context custom could 'tip the balance' in cases of ambiguous legislation. *Bosch* recognised that the rule had to be adapted to contextual statutory interpretation. The rationale for relying on consistent interpretation by those responsible for the administration of legislation also

changed from 'custom' to the assistance that could be gained from their evidence in determining 'the meaning that should reasonably be placed upon those words.'

(v) That missing from this reformulation was any explicit mention of a further fundamental contextual change, that from legislative supremacy to constitutional democracy.

(vi) That the court posed the question: Why should a unilateral practice of one part of the executive arm of government play a role in the determination of the reasonable meaning to be given to a statutory provision? It might conceivably be justified where the practice is evidence of an impartial application of a custom recognised by all concerned, but not where the practice is unilaterally established by one of the litigating parties. In those circumstances it is difficult to see what advantage evidence of the unilateral practice will have for the objective and independent interpretation by the courts of the meaning of legislation, in accordance with constitutionally compliant precepts and it was best avoided.

(vii) That the Respondent had submitted that the Supreme Court of Appeal in any event had first interpreted the relevant provisions independently of the Interpretation Notes and that its independent interpretation was correct and the court agreed that an objective, independent interpretation of the relevant sections of the Act led to the conclusion that the Supreme Court of Appeal came to.

(ix) That section 7(1) of the VAT Act attracted payment of VAT on actual services supplied by vendors. The deeming provision in section 8(5) extended payment of VAT to services that were not covered by section 7(1). The designated entities to which section 8(5) applied were government-subsidised entities. A government subsidy is not an actual supply of services that attracts payment of VAT under section 7(1). Section 8(5) deems the subsidy to be a taxable supply subject to the payment of VAT. The zero-rating provided for in section 11(2)(*n*) assisted only one of the designated entities covered by the deeming provision in section 8(5), namely welfare organisations.

(x) That the Trust provided actual services to provincial departments in terms of its agreements with them, and was liable to payment of VAT on those actual services. Any payment of subsidies to it by a public authority deemed to be a taxable supply of services under section 8(5) was however subject to zero rating by virtue of the Trust being a welfare organisation under the Act.

(xi) That the application for leave to appeal had to be refused as the prospects of success were not good and it is not normally in the interests of justice to grant leave.

Condonation for the late filing of the application for leave to appeal was granted but the application for leave to appeal was refused and there was no costs order.

5.11. ITC 1911 – Tax Administration

The Applicants, in two identical applications, were both companies with limited liability incorporated in South Africa.

Both applications were made to the Johannesburg Tax Court in terms of Tax Court Rule 52(2)(*a*) promulgated under section 103 of the Tax Administration Act.

In terms of Tax Court Rule 52(2)(*a*) a taxpayer may apply to the Tax Court, if SARS fails to provide the reasons for an assessment under Rule 6 which are required to enable him or her to formulate an objection in the form and manner referred to in Rule 7, for an order that SARS must provide, within the period allowed by the court, the reasons regarded by the court as required to enable the taxpayer to formulate the objection.

SARS had issued a section 80J(1) notice to the Applicants in terms of the Income Tax Act setting out the audit findings and the basis upon which SARS believed that the General Anti-Avoidance Rule ('GAAR') provisions applied in respect of the arrangements entered into by the Applicants.

The Applicants' response to the notice stated their reasons as to why the provisions of GAAR were not applicable to the arrangements entered into by them

and their response was that they were neither aware of, nor were they a party to any such transactions and agreements as set out in the notice.

SARS subsequently requested additional information from the Applicants and they had responded to the request by furnishing the required additional information.

SARS, thereafter, issued additional assessments to the Applicants which had been raised through the application of GAAR, in particular sections 80A–L of the Income Tax Act.

SARS' assessment letter had stated *inter alia* that 'based on the audit findings, the following adjustments have been made to your assessment' and the adjustments relevant to the Applicants were described in the table inserted in the assessment and stated that 'exempt dividend income' had been 're-characterised as taxable income.'

SARS' assessment letter referred to each 'arrangement' as including subscriptions for preference shares and resulting tax exempt dividends and secondary tax on companies ('STC') credits; funds were ultimately invested by entities in the group, through a series of transactions, in interest-bearing linked notes from a bank and various intervening transactions created income tax and STC benefits and the investment by an entity in the group in 'underlying paper and the interest arising thereon' which resulted in taxable interest passing back to the Applicants in the form of tax exempt dividends that conferred STC benefits on them.

The Applicants were clearly aggrieved by SARS' additional assessments and, as a result, they had requested SARS to provide reasons for the additional assessments in terms of rule 6(1) of the Tax Court Rules and their motivation for the request for reasons was to formulate an objection to the additional assessments as provided for in rule 7.

The Applicants' request for reasons sought to identify the 'transaction, operation, scheme, agreement or understanding' which was included in each 'arrangement' relied on by SARS in the assessment.

The aforementioned request sought to establish the basis on which SARS had contended that each relevant 'arrangement' had satisfied the 'abnormality'

requirement of an impermissible tax avoidance arrangement in terms of section 80A of the Income Tax Act.

Section 80B of the Act provided SARS with a discretion to determine the tax consequences of any impermissible avoidance arrangement and section 80A of the Act provided for the definition of impermissible avoidance arrangement whose main purpose must have been to obtain a tax benefit and must result in a tax benefit.

SARS' response to the Applicants' aforementioned request was contained in a letter dated 7 June 2016 in which it was stated that SARS was satisfied that the letter of assessment in issue contained sufficiently detailed reasons for the additional assessments.

Moreover, SARS stated that the aforementioned letter served as the notification provided for in rule 6(4) of the Rules, i.e. SARS was satisfied that the reasons required to enable the taxpayer to formulate an objection had been provided and had notified the taxpayer accordingly.

The Applicants contended that SARS' letter of 7 June 2016 was tantamount to a refusal to provide the reasons as requested.

The Applicants submitted that it was crucial that they obtained clear reasons to avoid potential prejudice attendant upon them when filing for objection as provided for in rule 34 which only allows for the grounds stated in the objection and they could not raise new grounds in their appeal.

The Applicants further submitted that the request for reasons constituted administrative action, and therefore was consistent with the requirements of section 33 of the Constitution.

The sole issue before the Tax Court was whether SARS had provided the Applicants with adequate reasons in order to enable them to formulate objections to the additional assessments.

Judge Mali held the following:

(i) That rule 6(1) of the Tax Court Rules provides that a taxpayer who is

aggrieved by an assessment may, prior to lodging an objection under rule 7, request SARS to provide reasons for the assessment required to enable the taxpayer to formulate an objection in the form and manner referred to in rule 7.

(ii) That the Applicants contended that they were entitled to adequate reasons and in this regard the court was referred to the case of *Minister of Environmental Affairs and Tourism* v *Phambili Fisheries* 2003 (6) SA 407 (SCA) ('*Phambili*'). The Applicants further contended that they were not challenging the merits of the case as was the position in *C: SARS* v *Sprigg Investment 1177CC t/a Global Investment* 73 SATC 114 ('*Sprigg*').

(iii) That it appeared that there were significant similarities between this case and *Sprigg*. The taxpayer in *Sprigg*, in response to the letter of audit findings, submitted a detailed response in which it had denied the main conclusions reached by SARS and, subsequent to SARS raising assessments, *Sprigg* requested the Commissioner to furnish the reasons for the assessment. The *Sprigg* pattern is found in the present matter in that the Applicants responded to the Notice and that was not the end of the matter. When SARS requested additional information to the Applicants' response, they went into great lengths to provide the information.

(iv) That in the Applicants' letter of 26 November 2015 read with their response to the Notice, it was apparent that the Applicants clearly understood the arrangements referred to and all transactions referred to in the tax benefit leg.

(iv) That the principle established in *Phambili* was that the party whom the decision has been taken against, must be given adequate reasons that will make the party understand why the decision went against it, even if it did not agree with the decision. *Phambili* further established that the decision-maker is required to set out his understanding of the relevant law, the findings of fact on which his conclusions depend, and the reasoning process which led him to his conclusions and reasons should be properly informative and they must explain why the decision was taken.

(v) That in turning to enquire whether SARS' decision met the *Phambili* test,

the court looked at SARS' understanding of the relevant law which it found to have been clearly set out (i.e. section 80B as the charging provision) and examined SARS' findings of fact on which its conclusions depended and found that it was apparent that the facts were contained in SARS' Letter of Findings and its response.

(vi) That in applying the law into facts SARS had clearly reached a conclusion that in respect of Income Tax, exempt dividend income had been re-characterised as taxable interest income in respect of all the years of assessment and, in respect of STC, dividends received from net amount had been reversed.

(vii) That, in regard to many of the issues, there was a clear understanding thereof by the Applicants and this could be seen in their letter of 26 November 2015 and it was therefore reasonable to believe that both the Applicants and SARS were referring to the same thing. Moreover, the sudden misunderstanding or lack of adequate reasons as submitted by the Applicants was baffling and it appeared that the Applicants sought clarity or reasons as to what they had already answered and therefore the Applicants' request was a delaying tactic.

(ix) That, having regard to the above, the court found that there was nothing more to be done by SARS to satisfy the Applicants and, accordingly, SARS had satisfied the *Phambili* requirements and the Applicants would not be prejudiced in formulating their objection against the SARS letter of assessment.

(x) That, accordingly, SARS was not obliged to provide reasons for its additional assessments as had been requested by the Applicants in terms of rule 6 of the Tax Court Rules.

Application dismissed with costs, including the costs of two counsel.

5.12. ITC 1912 – Tax Administration

SARS had brought an interlocutory application in the Johannesburg Tax Court in which it had sought to strike out a portion of the taxpayer's statement of grounds of appeal filed in terms of rule 32 of the Tax Court Rules.

The gist of SARS' complaint was that the taxpayer's rule 32 statement was inconsistent with rule 32(3) as it contended that this sub-rule prohibited a taxpayer from introducing a new ground of objection in its rule 32 statement.

The taxpayer, on the other hand, adopted a different interpretation of rule 32(3) and contended that while it indeed had introduced a new ground of objection, this fell within the parameters of what was permissible under rule 32(3).

Rule 32(3) provided that the taxpayer may not include in the statement of grounds of appeal a ground of appeal that constitutes 'a new ground of objection against a part or amount of the disputed assessment not objected to under rule 7.'

SARS had issued various tax assessments to the taxpayer and the taxpayer had lodged objections which had been disallowed by SARS and in both cases the disallowances had related to capital losses the taxpayer had claimed in relation to an employee share trust scheme.

The taxpayer had lodged notices of appeal against the disallowances and SARS duly delivered its statement of grounds of assessment opposing the appeal in terms of rule 31.

In its aforementioned statement SARS had recorded that the taxpayer had claimed capital losses in specified sums for each of the six years of assessment and these losses were in respect of shares held in the name of the taxpayer's Employee Share Trust ('the Trust'). The Trust disposed of these shares to employees of the taxpayer at a sum less than the base cost of the shares and SARS stated that the shares were owned by the Trust and not by the taxpayer. They were not assets of the taxpayer, and the transfer to employees did not constitute a 'disposal' by the taxpayer. As such, the taxpayer could not claim capital losses arising in the Trust as capital losses for the taxpayer itself for purposes of calculating the latter's taxable capital gain.

The taxpayer delivered its statement in terms of rule 32 and in this document the taxpayer expressly recorded that- 'This Rule 32 statement contains new grounds of appeal that differ from the approach previously relied on by the appellant. However, the grounds of appeal set out below relate precisely to what was objected to and appealed against in the disputed assessments.'

The taxpayer expressed the view that this was permissible in terms of rule 32(3) for reasons that were advanced in the statement

The taxpayer, in terms of its grounds of appeal, contended that the terms of the trust deed created rights for the taxpayer against the Trust in terms of which the Trust was obliged to offer and acquire the shares at the expense of the taxpayer and these rights constituted assets for the taxpayer, at a base cost of the expenditure actually incurred by the taxpayer and this base cost was equal to the losses made on the acquisition and disposal by the Trust of the shares. These rights (assets) were extinguished when the Trust performed its obligations, and the taxpayer suffered a consequent capital loss for capital gains tax purposes.

It was important to record that the taxpayer conceded in its rule 32 statement that it could not claim capital losses *qua* capital losses of the Trust. In other words, it could no longer support the position it had adopted in its objection and notice of appeal, *viz* that the capital losses arising in the Trust were to be treated directly as the capital losses of the taxpayer on the basis of its previously held contention that the taxpayer was the sole beneficiary of the Trust and it was this turnaround by the taxpayer that led to the present dispute between the parties.

The heart of the dispute was the proper interpretation of rule 32(3).

SARS contended that it did not permit a new ground of appeal which constituted a new ground of objection that was not raised previously whereas the taxpayer contended that a new ground of objection was not outlawed under rule 32(3) and thus the first issue that arose was an interpretive one and the following issue that arose was whether, in terms of the interpretive approach adopted by the court, M's new grounds of appeal actually constituted impermissible new objections or not.

Judge Keithley held the following:

As to the interpretation issue

(i) That a fundamental difficulty in SARS' interpretive approach is that it simply does not account for the actual wording of rule 32(3). In relevant part, and without repeating the entire clause, it provides that the taxpayer may not include in its statement 'a ground of appeal that constitutes a new ground of objection against a part or amount of the disputed assessment not objected to under Rule 7.' (Emphasis added).

(ii) That the emphasised portion of the provision was important and it had to be given some meaning. If the purpose of rule 32(3) was to prohibit new grounds of objection not filed under rule 7, this would simply be achieved by placing a full stop after the phrase 'new ground of objection.' But this is not what the provision says. In plain language, it links the prohibited objection ('may not object') to the 'part or amount' not 'objected to' under rule 7 and this provision can only be read in one way: it prohibits the taxpayer from appealing against 'a part or amount' of the assessment that was never objected to when the rule 7 objection was filed.

(iii) That, linguistically, SARS' interpretation simply does not fit and it ignores the phrase 'a part or amount of the disputed assessment.' However, this phrase is the working part, or focus, of the prohibition. In other words, what is prohibited is for a taxpayer to appeal against a portion of the assessment in respect of which no objection was ever raised.

(iv) That, moreover, the linguistic problems inherent in SARS' interpretation of rule 32(3) cannot be ascribed to mere bad drafting. This was clear if one considered rule 10(3) and rule 10(4). Rule 10(3) contained a prohibition stated in virtually the same terms as rule 32(3) but, despite this, rule 10(4) reads as follows:

> 'If the taxpayer in the notice of appeal relies on a ground not raised in the objection under Rule 7, SARS may require a taxpayer within 15 days after delivery of the notice of appeal to produce the substantiating documents necessary to decide on the further

progress of the appeal.'

The two sub-rules, rule 10(3) and rule 10(4) would be contradictory unless rule 10(3) was interpreted to permit new grounds not raised under rule 7.

(v) That it was clear from the scheme of the Tax Court Rules that the taxpayer is no longer restricted, on appeal, to the grounds of objection originally filed under rule 7. Provision is made for new grounds to be advanced in rule 10(4) and in rule 33. The latter rule introduces the innovation that SARS may now file a reply to the taxpayer's rule 32 statement. That reply must deal with 'any new grounds'. The other relevant innovations included in the present rules were rule 31(3) and 32(3) and it was also significant that under the present rules statements made under rule 31, 32 and 33 may be amended, either by agreement or on application to court. This was further evidence of an intention to broaden, rather than to restrict, the ambit of the issues that could be dealt with in the tax appeal process.

(vi) That these changes demonstrated a new flexibility in the tax appeal process and a move away from the rigidity that previously characterised the regime. This development was in line with the constitutional right to access to court, which guarantees a fair hearing. Rigidity in the legal process can thwart the fairness of proceedings. There would seem to be no good reason to restrict unduly the ambit of a tax appellant's grounds of appeal and this was particularly so when one had regard to the fact that a tax appeal to the Tax Court involved a full hearing, with the leading of witnesses, cross-examination and discovery.

(vii) That SARS' interpretation of rule 32(3) in this application was correct in that it was not aimed at prohibiting the introduction of a new ground of objection not raised under rule 7. The ambit of the prohibition is more limited: what a taxpayer may not do is to use rule 32(3) to appeal against a portion of the assessment (either in terms of an amount or part) not previously objected to under rule 7. A taxpayer may raise a new ground of objection in the rule 32 statement, provided that it relates to a part or an amount in the assessment that was placed in dispute by the objections stated under rule 7.

(viii) That this placed the taxpayer in an equivalent position to SARS which,

under rule 31(3), could include a new ground in its statement, provided that it did not amount to a novation of the assessment, or was such that it required a new assessment.

(ix) That SARS was not prejudiced in this process as it may reply to a new ground stated in the rule 32 statement, and it will have the full armoury of amendment, discovery and the leading of evidence to deal with the ground of objection at the hearing of the appeal. The flexibility inherent in the process under the present rule brings the parties closer to a position of equality of arms in the procedural sphere, and ensured that a rigid process did not prevent justice from being done and was in accordance with section 34 of the Constitution.

(ix) That, therefore, on a proper interpretation of rule 32(3), as a matter of law, the taxpayer was not precluded from raising a new ground of objection in its statement.

As to the new ground of objection

(x) That it was common cause that the new objection raised by the taxpayer was in respect of the same amounts and the same parts of the assessment objected to under rule 7 and was therefore a permissible ground.

(xi) That there was no merit in the SARS submission that insofar as the rule permit new grounds of objection in a rule 32 statement, this did not extend to new grounds that were in substance not the same as those stated under rule 7. There was nothing in the language or the structure of the tax appeal process established under the present rule to suggest that any distinction should be drawn between grounds that were covered in substance under rule 7 and those that were not. The provisions offered no assistance on where the line should be drawn between these categories, and there was no hint in the language of the provisions that they were ever intended to have this purpose.

(xii) That it was common cause that the new ground of appeal involved exactly the same amounts that formed the basis of the taxpayer's objection under rule 7. In its new ground stated in its rule 32 statement, the taxpayer

sustained the same objection it did under rule 10. However, when properly understood, it did not seem to amount to the 'seismic shift' contended for by SARS and the underlying commonalities between the original and the new approaches outweighed the changes.

(xiii) That on a proper examination of the grounds, the change in approach adopted by the taxpayer under its new grounds of appeal essentially involved a re-packaging, for want of a better word, of the legal basis on which the taxpayer now contends that the losses suffered in executing the scheme amounted to capital losses for the taxpayer. The original objection was based on the taxpayer being the sole beneficiary of the Trust, while the new grounds place reliance on the taxpayer funding the purchase of the shares and bearing, both legally and de facto, the losses suffered in the process. In substance, it was the same issue that was before the court on appeal: whether the capital losses arising from the employee share option scheme were capital losses which were deductible by the taxpayer for capital gains tax purposes.

(xiv) That the fact that the taxpayer had adopted a different approach to the same issue would not place SARS at an unfair disadvantage. SARS would have all the tools at its disposal to ensure that the issues were fully ventilated at the appeal hearing. SARS had correctly conceded at the hearing that if this application were not successful, there would be no prejudice to SARS in the appeal.

(xv) That in these circumstances, to uphold the application and strike out the new grounds of appeal from the rule 32 statement would amount to placing form, or technicalities, over substance, and would be contrary to the interests of justice in this case.

(xvi) That, for these reasons too, there was no substance in SARS' contention that the new grounds included in the rule 32 statement were impermissible and excipiable and it followed that the interlocutory application fell to be dismissed.

Application dismissed with costs.

6. INTERPRETATION NOTES

6.1. Section 24I – Gains or losses on foreign exchange transactions – No. 101

This Note provides guidance on the interpretation and application of section 24I. Section 24I deals with the income tax treatment of foreign exchange gains and losses on exchange items as well as premiums or like consideration received or paid in respect of FCOCs entered into and any consideration paid in respect of an FCOC acquired by certain persons.

The tax treatment of transactions denominated in a foreign currency often requires a consideration of section 24I and other provisions of the Act. This Note identifies some of the situations in which one or more of these provisions may apply. For example, if trading stock, the purchase price of which is denominated in USD, is purchased on credit from a supplier, the provisions of section 25D and section 24I are relevant.

The income tax treatment of virtual currencies (cryptocurrencies and non-cryptocurrencies) is not considered in this Note.

This Note withdraws and replaces Practice Note 4 'Income Tax: The Treatment of Gains and Losses on Foreign Exchange Transactions in terms of Section 24I of the Income Tax Act, 1962 (the Act)'.

This Note reflects the income tax and tax administration legislation (as amended) at the time of publishing and includes the following:

- The Taxation Laws Amendment Act 17 of 2017 which was promulgated on 18 December 2017 (as per *Government Gazette* 41342).
- The Tax Administration Laws Amendment Act 13 of 2017 which was promulgated on 18 December 2017 (as per *Government Gazette* 41341).
- The Rates and Monetary Amounts and Amendment of Revenue Laws Act 14 of 2017 which was promulgated on 14 December 2017 (as per *Government Gazette* 41323).

Although the application of the section is limited to those persons listed in section 24I(2), the ambit of section 24I(2) is wide which results in the section being applicable to a large number of persons and transactions.

Under section 24I, exchange differences calculated for a year of assessment are generally included in or deducted from income whether realised or not and whether of a capital or revenue nature. The legislation was drafted in this manner in line with the view that gains and losses on foreign exchange transactions largely represent finance charges and as a result must be brought to account on a revenue basis for tax purposes at the end of a year of assessment even if not realised.

There are limited circumstances in which the inclusion of a foreign exchange gain or loss calculated in respect of an exchange item in a particular year of assessment is deferred and recognised in a later year of assessment.

Section 1(1) of the Tax Administration Laws Amendment Act 23 of 2015 deletes the reference to section 24I(7) from a date still to be determined by the Minister of Finance in the *Gazette*.

Section 24I(3) provides for an inclusion in or deduction from income of an exchange difference on an exchange item as well as any premium or like consideration received by or paid by a person under an FCOC entered into by that person or any consideration paid for an FCOC acquired by a person. The term 'exchange item' of or in relation to a person means an amount in a foreign currency:

- which constitutes any unit of currency acquired and not disposed of by that person;
- owing by or to that person on a debt incurred by or payable to such person;
- owed by or to that person in respect of an FEC; or
- when that person has the right or contingent obligation to buy or sell that amount under an FCOC.

Section 24I applies to the following persons indicated in section 24I(2):

- Any company.
- Any trust carrying on any trade.
- Any natural person who holds any amount in a foreign currency which constitutes a unit of currency, or which is owing to that person on a debt payable to that person, as trading stock.
- Any natural person or trust in respect of any amount in foreign currency:
    - owed by or to that person in respect of an FEC; or
    - when that person has the right or contingent obligation to buy or sell that amount under an FCOC.
- Any of the persons referred to above that are non-resident in relation to an exchange item that is attributable to a permanent establishment of that person in the Republic.
- Any CFC for purposes of determining its net income under section 9D(2A) that must be included in the income of persons that are residents under section 9D(2).

An exchange difference is determined on each exchange item for the year of assessment in which such exchange item arose and every subsequent year of assessment until and including the year of assessment in which such exchange item is realised.

The exchange difference for a specific year of assessment is determined by multiplying the foreign currency amount of the exchange item by the difference between the ruling exchange rate on the commencement date in that year of assessment and the ruling exchange rate on the final date in that year of assessment.

Section 24I(4) provides that, subject to section 11, to the extent that a debt owing to a person has become bad, the amount of any foreign exchange gain relating to that debt that is or was included in the income of a person in the current or any previous year of assessment must be deducted from the income of that person, and the amount of any foreign exchange loss relating to that debt that is or was

deducted from the income of that person in the current or any previous year of assessment must be included in the income of that person.

With effect from years of assessment ending after 1 January 2017.

Section 24I(6) prohibits the deduction from or inclusion in income of an amount referred to in section 24I(3) under any other provision of the Act.

Section 24I(7) provides for the carry-forward of the inclusion in, or deduction from, a person's income of certain exchange differences and premiums or other consideration which arose or were paid or became payable in a year of assessment before the year of assessment during which the assets referred to in section 24I(7)(*a*) were or are brought into use for the purposes of the person's trade. The foreign exchange gain or loss is generally carried forward to the year of assessment in which the assets to which they relate are brought into use for purposes of that person's trade. In certain circumstances the carried forward exchange difference may be recognised in a year of assessment before the year of assessment in which the relevant asset is brought into use. Special rules apply to mining assets.

Section 24I(8) provides that any foreign exchange loss sustained on a transaction entered into by a person, or any premium or other consideration paid in respect of or under an FCOC entered into or acquired by a person, shall not be allowed as a deduction from such person's income under section 24I(3), if the transaction was entered into or the FCOC was entered into or acquired solely or mainly to enjoy a reduction in tax as a result of a deduction from income.

Under section 24I(10A)(*a*) an exchange difference arising during any year of assessment in respect of an amount in a foreign currency owing by or to a person on a debt shall not be included in or deducted from the income of that person if at the end of that year of assessment that person and the other party to the contractual provisions of the debt form part of the same group of companies or are connected persons in relation to each other and if certain requirements are met.

Section 24I(12) determines that when a person holds any exchange item and section 24I at any time during a year of assessment:

- becomes applicable to that person, that exchange item shall be deemed to have been acquired at that time for the purposes of section 24I; or
- ceases to apply to that person, that exchange item shall be deemed to have been realised at that time for the purposes of section 24I.

In applying section 24I, regard must be had to other provisions of the Act, amongst others, the definition of 'trading stock' in section 1(1), sections 3(4)(*b*), 6*quat*, 8(4)(*a*), 9(2)(*l*), 9(4)(*e*), 9D, 11(*a*), 11(*i*), 11(*j*), 19, 20(2), 22(3)(*a*)(i), 24J and 25D, paragraphs 12A and 43 of the Eighth Schedule, and paragraph 4(1) of the Tenth Schedule.

6.2. Classification of risk policy and the once-off election to transfer certain policies or classes of policies issued before 2016 to the risk policy fund – No. 102

This Note provides guidance on:

- the interpretation and application of the definition of 'risk policy' in section 29A(1); and
- the once-off election by an insurer to transfer certain policies or classes of policies issued before 1 January 2016 to the risk policy fund under section 29A(13B).

The taxable income derived by any insurer in respect of any year of assessment must be determined in accordance with the Act, but subject to sections 29A and 29B.

Every insurer is required to establish five separate funds and to maintain such funds. These funds form the foundation for the operation of section 29A as a whole. The taxable income derived by an insurer in respect of the untaxed policyholder fund, the individual policyholder fund, the company policyholder fund, the corporate fund and the risk policy fund must be determined separately in accordance with the Act as if each such fund had been a separate taxpayer.

Section 29A was thus amended to provide that risk policies be taxed in the risk policy fund. The risk policy fund was introduced as one of the five funds because of concerns that the taxation of insurers under the previous four funds did not distinguish between investment and risk business. In practice, a risk policy will pay out a specified cash amount on the happening of an event regardless of the amount of investment income earned during the term of the policy. This could result in a loss in respect of a specific policy.

Some insurers requested guidance relating to which policies issued on or after 1 January 2016 can be classified as risk policies. The once-off election by an insurer to transfer qualifying policies or classes of policies to the risk policy fund also needs clarification.

The risk policy fund has been introduced as a fifth fund for insurers to distinguish between investment and risk business. Any policy issued by an insurer during any year of assessment commencing on or after 1 January 2016 meeting the requirements of the definition of 'risk policy' must be allocated to the risk policy fund.

The rights and obligations of each policy will determine whether the requirement of 'substantially the whole' has been met. In order to give effect to the manner in which the insurance business is conducted, products having similar contractual rights and obligations could be grouped together as a class or sub-class of policies. The respective classes or sub-classes of policies should, however, comply with the 'substantially the whole' requirement to qualify as risk policies.

An insurer has a once-off election to transfer all policies or one or more classes of policies issued before 1 January 2016 to the risk policy fund if those policies or classes of policies meet the necessary requirements.

6.3. *Resident: Definition in relation to a natural person – physical presence test – No. 5*

A natural person, who is not at any time ordinarily resident in South Africa during the relevant year of assessment, must comply before that person will be a "resident" as defined in section 1(1).

South Africa's tax system has been residence-based since years of assessment commencing on or after 1 January 2001. For a natural person, this was the commencement of the 2002 year of assessment, that is, 1 March 2001. Persons who are "resident" in South Africa are taxed on their worldwide income, subject to certain exclusions. Persons who are not resident are only taxed on their income from a source within South Africa.

A natural person can become a resident for income tax purposes by:

- being ordinarily resident in South Africa or
- complying with all the requirements of the physical presence test.

This Note focuses solely on the application of the physical presence test.

For more information on the concept of "ordinarily resident", see Interpretation Note 3 "Resident: Definition in Relation to a Natural Person – Ordinarily Resident".

A resident of South Africa is subject to tax on worldwide income in accordance with paragraph (i) of the definition of the term "gross income" in section 1(1). An individual can either be ordinarily resident, or can be deemed to be a resident by application of a physical presence test. The physical presence test is applied annually.

An individual who meets the requirements of the physical presence test is a resident from the first day of the year of assessment during which the requirements of the test are met.

An individual ceases to be a resident in terms of the physical presence test if that individual is outside the Republic for at least 330 continuous full days.

Any individual who is deemed to be a resident by virtue of the physical presence

test is subject to tax on worldwide income. The individual will therefore be required to declare all receipts and accruals in this regard.

6.4. Deduction of security expenditure – No. 45 (Issue 3)

This Note provides guidance on the deductibility of security expenditure incurred by a taxpayer for income tax purposes. It also examines the fringe benefits tax implications for employees when their employers fund such expenditure.

Taxpayers incur a variety of expenditure for the purpose of preventing and combating crime in South Africa. Such security expenditure usually falls within one of the following categories:

- Expenditure of a domestic or private nature
- Donations
- Business-related expenditure

This Note examines each of these categories of expenditure.

In determining whether security expenditure incurred by a taxpayer qualifies for a deduction, the facts and circumstances of each case must be taken into account.

6.5. The VAT treatment of supplies of international and ancillary transport services – No. 103

This Note sets out the:

- VAT treatment of the international transportation of passengers and/or goods;
- VAT treatment of ancillary transport services; and
- rate of tax applicable to each of the aforementioned transportation services.

The supply of international transport services generally involves more than one party and various supplies in order to effect the movement of passengers or goods

from one place to another. It is important for a vendor involved in the supply of transportation services, ancillary transport services or the arranging thereof to determine what the service is that it is rendering as the rate at which VAT must be levied will depend thereon. In this regard, it is essential to have regard to the agreements in place between the supplier of the services and the recipient thereof.

The VAT Act makes provision for the supply of transportation of passengers or goods to be subject to VAT at the zero rate under certain circumstances.

In order to ascertain the correct VAT treatment of the supply of international transport services, the vendor must consider the nature of the service and the requirements of the relevant provisions of the VAT Act. A detailed discussion of the applicable provisions of the VAT Act which are relevant to the supplies of transport services is set out below.

This Note does not deal with the VAT treatment of exempt passenger transport as envisaged in section 12(*g*).

The international transportation of goods or passengers is a taxable supply, and so is the supply of any ancillary transport services associated with it. These services must however, be zero-rated under the various provisions contained in section 11(2) subject to the requirements for the zero-rating being met. In this regard, it is important to note that should the vendor fail to obtain and retain the documentary evidence acceptable to the Commissioner set out in Interpretation Note 31 within the prescribed time periods, the supply will not qualify to be zero-rated. Furthermore, a vendor supplying domestic or ancillary transport services in connection with imported or exported goods must establish whether the vendor has contracted directly with a non-resident, non-vendor, or with the agent of the non-resident non-vendor, before applying the zero or standard rate.

7. BINDING PRIVATE RULINGS

7.1. BPR 306 – Donation to a special trust

This ruling determines the donations tax consequence of a cash transfer made to a special trust.

In this ruling references to sections are to sections of the Act applicable as at 21 February 2018. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of sections 54 and 55.

Parties to the proposed transaction

The applicant: A resident adult suffering from a debilitating malady

Trust: A discretionary *inter vivos* trust created by the applicant and registered as a special trust

Description of the proposed transaction

The applicant suffers from an early onset of dementia, but is currently still lucid and has the capacity to contract. The applicant will transfer an amount to the trust in order to provide for her future upkeep and wellbeing. This amount does not represent the applicant's entire estate. The trust provides for primary and secondary beneficiaries. The applicant is the primary beneficiary, and her descendants are the secondary beneficiaries.

Both the primary and the secondary beneficiaries are contingent beneficiaries as their rights to receive income or assets are subject to the exercise of the trustees' discretion. The trustees may only exercise their discretion in respect of the secondary beneficiaries on the passing of the primary beneficiary.

The purpose of the trust is to take care of the applicant when she becomes debilitated by her medical condition, by providing for her care and maintenance.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions or

assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The amount to be contributed by the applicant will not constitute a donation as contemplated in sections 54 and 55, and, as a result, no donations tax will be levied.

7.2. BPR 307 – Relief from double taxation of interest

This ruling determines whether South Africa or Brazil has the taxing rights in respect of interest income on bonds issued by the government of Brazil and paid to a South African resident.

In this ruling references to sections are to sections of the Act and references to paragraphs are to paragraphs of article 11 of the South Africa/Brazil Treaty applicable as at 25 May 2018. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of section 108 and paragraph 4(b) of article 11 of the South Africa/Brazil Treaty.

Parties to the proposed transaction

The applicant: A resident company

Description of the proposed transaction

The applicant proposes to enter into trades in respect of bonds issued by the Brazilian government (bonds).

The applicant will:

- enter into a purchase and resell agreement with international counterparties in terms of which it will acquire bonds from the counterparties and will agree to sell back the bonds to the counterparties on specified dates and for specified prices which will each include an interest component; and
- acquire bonds in the market without any associated resell arrangements.

The applicant may in either case receive interest from the Brazilian government as issuer of the bonds during the term of the transaction.

The interest that the applicant will receive is not subject to tax in Brazil.

In respect of the purchase and resell agreement, the applicant will pay the counterparties so-called manufactured payments calculated with reference to the interest it will receive while holding each bond.

The applicant will recognise the purchase and resell agreements and the bonds at fair value in profit or loss in terms of International Financial Reporting Standard 9, and section 24JB(2) will apply to the instruments.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- Paragraph (4)(b) of article 11 of the South Africa/Brazil Treaty grants exclusive taxing rights to Brazil in respect of the interest that the Applicant will receive on the bonds. The interest will therefore not be taxable in South Africa.

Additional note

This ruling:

- does not cover the application or interpretation of any general or specific anti-avoidance provision or doctrine; and
- does not make any pronouncement on the deductibility of any expenditure incurred by the applicant in relation to the transactions.

7.3. *BPR 308 – Assumption of contingent liabilities and the cession of a right of recovery*

This binding private ruling is published by consent of the applicant(s) to which it has been issued. It is binding as between SARS and the applicant and any co-applicant(s) only and published for general information. It does not constitute a practice generally prevailing.

This ruling determines the tax consequences resulting from the sale of a mine in exchange for the assumption of liabilities by the purchaser, and the tax implications arising from the cession of a right of recovery.

In this ruling references to sections and paragraphs are to sections of the Income Tax Act and paragraphs of the Eighth Schedule to the Act applicable as at 2 July 2018. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1) – definition of "gross income"; and the inclusion in paragraph (*j*);
- section 37; and
- paragraph 35.

Parties to the proposed transaction

The applicant: A resident company

Co-applicant 1: A resident listed company

Co-applicant 2: A resident company that is a wholly-owned subsidiary of co-applicant 1

Description of the proposed transaction

The applicant is the owner of and has been conducting mining operations at a mine which is one of several owned by the applicant. The applicant and co-applicant 1 had some years ago entered into an arrangement in terms of which the mine's

product was sold exclusively to co-applicant 1 (the captive mine arrangement) who undertook in exchange to, amongst others, refund the bulk of the applicant's expenditure incurred in respect of any rehabilitation the applicant was liable to undertake in respect of the mine. The terms of the supply arrangement were subsequently renegotiated to enable the applicant to supply the commodity concerned also to persons other than co-applicant 1 but the undertaking to refund the rehabilitation expenditure remained in force.

Due to unfavourable circumstances, the applicant's board resolved to close the mine. Mining activities ceased, but existing stockpiles continued to be treated and the product stockpiles continued to be dispatched until the end of August 2016.

During April 2016, the applicant was approached by the co-applicants to consider the transfer of the mine. Co-applicant 2 intends to acquire the mine in order to attempt to revive it but also to take full management control of the processes and costs related to the rehabilitation liability at the mine.

It was calculated in terms of the captive mine arrangement that co-applicant 1 is accountable for 97% of the mine's current rehabilitation liability, while the applicant is responsible for the execution and management of all of the rehabilitation activities in accordance with the approved rehabilitation plan. The transfer would simplify matters by making the co-applicants solely responsible for the closure and rehabilitation of the mine.

The proposed transfer will take the form of a sale of assets and liabilities. Co-applicant 2 will purchase all of the assets pertaining to the mine at a nominal price of one rand, and assume all of the liabilities pertaining to the mine, including the environmental rehabilitation obligations, in one indivisible transaction (the purchase and sale agreement).

Co-applicant 2 will acquire by way of cession from the applicant, the right of recovery against co-applicant 1 that it had in terms of the supply agreement. Co-applicant 2 will be entitled to claim payment from co-applicant 1 upon the requisite payment of the respective rehabilitation and closure costs by co-applicant 2.

The contingent liabilities assumed by co-applicant 2 in terms of the purchase and

sale agreement (that constitute the embedded contingent liabilities for the purpose of this binding private ruling) will be:

- the environmental liabilities;
- the rehabilitation obligation;
- all statutory liability (including any historic liability) for the rehabilitation and closure of the mine, including the social closure obligations;
- all of the other obligations in terms of the mining rights, whether by virtue of the terms and conditions attaching to the mining rights, the Mineral and Petroleum Resources Development Act 28 of 2002, the regulations promulgated thereunder or any other applicable law; and
- the applicant's liabilities to the employees which arose on or after 1 October 2015.

For the avoidance of doubt, the liabilities to be assumed by co-applicant 2 will specifically exclude taxes, inter-company and treasury loans payable, deferred tax liabilities and trade payables or creditors of the applicant relating to so-called interim period costs already paid by co-applicant 2.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The market value of the contingent liabilities comprising:
  - the environmental liabilities;
  - the rehabilitation obligation;
  - all statutory liability (including any historic liability) for the rehabilitation and closure of the mine, including the social closure obligations;

- all of the other obligations in terms of the mining rights, whether by virtue of the terms and conditions of the mining rights themselves, the Mineral and Petroleum Resources Development Act, the regulations promulgated thereunder or any other applicable law; and
- the applicant's liabilities to the employees that arose on or after 1 October 2015,

assumed by co-applicant 2 in terms of the purchase and sale agreement, are not required to be included in the applicant's consideration for purposes of:

- the definition of "gross income" in section 1(1);
- the inclusion under paragraph (*j*) of that definition;
- section 37; or
- paragraph 35.

- No amount will be received by or accrue to the applicant upon the rehabilitation right of recovery becoming unenforceable by the applicant.
- No amount will be received by or accrue to the applicant as a result of the applicant ceding the right of recovery to co-applicant 2, for purposes of the definition of "gross income" or the Eighth Schedule to the Act.
- The cession of the right of recovery will not result in a capital gain or loss for the applicant as no expenditure will be incurred in relation to the right of recovery and no consideration will be received in respect of the cession.

7.4. BPR 309 – Disposal of an asset by a public benefit organisation

This binding private ruling is published by consent of the applicant(s) to which it has been issued. It is binding as between SARS and the applicant and any co-applicant(s) only and published for general information. It does not constitute a practice generally prevailing.

This ruling determines the tax consequences of the disposal of an asset by a public benefit organisation.

In this ruling references to sections are to sections of the Income Tax Act and references to paragraphs are to paragraphs of the Eighth Schedule to the Act, applicable as at 6 August 2018. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1), – definition of “gross income”; and
- paragraph 63A.

Parties to the proposed transaction

The applicant: A duly approved public benefit organisation

The purchaser: An independent and unconnected third party developer

Description of the proposed transaction

The applicant owns three properties that are adjacent to each other. The properties each consists predominantly of vacant land with a few buildings grouped together on sections of the land. The properties have to date been utilised to house the applicant’s organisation and to enable it to fulfil its various objectives as a public benefit organisation and in particular, to enable members of the public to conduct spiritual retreats.

The properties were acquired from the proceeds of solicited donations.

The income of the applicant has decreased and it is expected that this trend would continue in the future and that it would become increasingly difficult for the applicant to sustain and maintain its properties, and to earn sufficient income to continue to fulfil its core function of carrying on public benefit activities.

In response, the applicant had taken a decision to utilise the properties to generate additional income by using the properties for business. However, that income was insufficient, and applicant has decided to sell the properties.

The aggregate footprint of the buildings on the properties constitutes 4.9% of the

aggregate extent of the properties. As the properties will be consolidated on disposal, the usage area calculations were applied to the whole area of the properties and it was determined that only 8% of the consolidated property was used for business.

The applicant has therefore not violated the allowable 15% requirement in respect of business usage and accordingly substantially the whole use of the asset was directed at a purpose other than a business undertaking or trading activity.

The applicant proposes to sell the three properties to an unconnected and independent third party developer. The title of the properties will be consolidated as one in the deeds registry and it will be sold as a single property.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The proceeds on the disposal of the property will not form part of the applicant's "gross income" as defined in section 1(1); and
- The applicant must disregard any capital gain or capital loss determined in respect of the disposal of the property in terms of paragraph 63A(*b*)(i).

7.5. BPR 310 – Customer loyalty programme

This ruling determines the income tax and VAT consequences of a customer loyalty programme.

In this ruling references to sections are to sections of the Act, and the VAT Act, applicable as at 2 August 2018. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act, or the VAT Act.

This is a ruling on the interpretation and application of:

- section 11(*a*) read with section 23(*g*) of the Act; and
- sections 1(1), – definition of "consideration", 7(1)(*a*), and 10(23) of the VAT Act.

Parties to the proposed transaction

The applicant: A resident company trading in products and services

The trust: A resident trust set up to act as the vehicle to facilitate the management of the applicant's customer loyalty programme

The participants: Customers of the applicant who will earn points in respect of purchases made or services procured

Description of the proposed transaction

The applicant implemented a customer loyalty programme (the "programme") for the benefit of its customer base. Customers of the applicant will register for the programme as participants and will earn points for transactions with the applicant.

The applicant established a trust to act as the vehicle to facilitate the management of the programme and the participants will be appointed as beneficiaries of the trust.

The applicant will make a capital contribution at the end of each financial year to the trust. The board of the applicant will determine the amount of the contribution to be made to the trust based on the applicant's gross profit. Upon determination by the board of the contribution, the contribution will vest immediately in the participants in accordance with their participation ratios. This contribution will constitute the pool benefit to be shared, in the form of shares or customer credits, among the participants in proportion to the points they earned during that financial year.

The trust will use the contribution to buy shares in the applicant or its holding company, or the capital contribution may be applied to provide customer credits against the applicant to the participants. The customer credits will be acquired by the trust using the contribution, rather than the applicant simply allocating credits to customer accounts. The board of the applicant will stipulate how much of the

contribution must be applied by the trust to buy shares or customer credits on behalf of the participants.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The contributions to be made by the applicant will be deductible under section 11(*a*) read with section 23(*g*) of the Act in the year of assessment in which the board has determined the participants' allocations.
- The contribution to be made to the trust as part of the programme will be a reward to the participants for contributing to the profitability of the applicant in relation to the value of the business conducted with the participants. To the extent that there is no requirement for the participants and/or the trust to make a supply of goods or services to the applicant in return for the payment, the payment therefore will not constitute "consideration" as defined in section 1(1) of the VAT Act, as it will not relate to a supply of goods or services.
- Each share constitutes an "equity security" as defined in section 2(2) of the VAT Act. The issuing of shares by the applicant to the participants will constitute the supply of services (being financial services envisaged in section 2(1)(*d*) of the VAT Act).
- The payments made by the trust on behalf of the participants in respect of the supply of the shares will constitute "consideration" as defined in section 1(1) of the VAT Act for an exempt supply under section 12(*a*) of that Act.
- Payments made by the trust to the applicant towards obtaining customer credits on behalf of the participants:
    - will constitute "consideration" as defined in section 1(1) of the VAT Act, to the extent that the amounts paid are applied towards paying

for goods already supplied by the applicant to the participants (the original supply). Under section 9(1) of the VAT Act, the Original Supply shall be deemed to take place at the earlier of the time when such consideration is received or an invoice for such supply is issued. Should the consideration be received before an invoice is issued, the applicant will be required to account for VAT (at the relevant rate) in the tax period in which the consideration is so received. Should the invoice be issued before such receipt, the applicant will be required to account for VAT on the original supply in the tax period in which such invoice is issued; and

- do not constitute "consideration" as defined in section 1(1) of the VAT Act, to the extent that the amounts paid will be applied against future supplies of goods made by the applicant to the participants.

8. BINDING GENERAL RULINGS

8.1. BGR 39 (Issue 2) – VAT treatment of municipal affected by changes to municipal boundaries

This BGR:

- explains the VAT treatment of the transfer of any assets, liabilities, rights and obligations pursuant to the merger, creation and disestablishment of municipalities as a result of any municipal boundary change as contemplated under section 8(28); and
- withdraws the first issue of BGR 39 dated 27 January 2017 with effect from 1 April 2018.

Background

From time-to-time the Municipal Demarcation Board may consider applications to change municipal boundaries under the Structures Act.

The municipal boundary changes, which affect so-called 'existing municipalities',

are dealt with under section 31 of the Local Government: Municipal Demarcation Act 27 of 1998. In terms of that Act, the legal, practical and other consequences resulting from the area of a municipality being wholly or partially incorporated in or combined with the area of another municipality must be dealt with under the Structures Act.

Section 14 of the Structures Act regulates the effects of the establishment of a municipality on existing municipalities and provides, amongst others, that:

- a municipality established under section 12 of the Structures Act supersedes the existing municipality or municipalities to the extent that the existing municipality or municipalities fall within that area;
- the superseding municipality becomes the successor in law of the existing municipality (subject to certain provisions dealing with the sharing of functions between local municipalities and district municipalities); and
- the notice required under section 12 of the Structures Act must contain certain information about the disestablishment as well as the various aspects relating, for example, to staff matters and the transfer of administrative records, assets, liabilities, rights and obligations from the existing municipality to the superseding municipality or municipalities.

As the VAT Act did not previously have a comparable provision to section 14 of the Structures Act, which deals with the potential supplies of goods or services that may occur as a result of any municipal boundary change, the first issue of BGR 39 was issued on the basis of an arrangement under section 72 to deal with such matters. The VAT Act was subsequently amended by the insertion of section 8(28), rendering the arrangement under section 72 redundant. However, as there is still a need to explain the application of section 8(28), this BGR has been amended accordingly.

Ruling

In the case of the transfer of all assets, liabilities, rights and obligations of an existing municipality (transferor) to a superseding municipality (transferee) as a result of a municipal boundary change, such municipalities are deemed to be one

and the same person for the purposes of section 8(28), provided that such municipalities are merged into a single municipality.

In the case of the transfer of only some of the assets, liabilities, rights and obligations as a result of the municipal boundary change, where the municipalities concerned continue to exist as separate persons, then the existing municipality (transferor) is deemed not to have made a supply to the superseding municipality (transferee) in that regard.

The effect of the ruling is that as at the effective date of the municipal boundary change:

- no supply of any goods or services is made by the existing municipality for the purposes of section 7(1)(*a*), and consequently, there will be no output tax payable by the existing municipality under section 16(4);
- no goods or services are acquired by the superseding municipality from the existing municipality, and consequently, no input tax deduction will be allowed under section 16(3) to the superseding municipality;
- no change of use adjustments under section 18 will be allowed to, or required by, either the existing municipality or the superseding municipality;
- an output tax or input tax adjustment may be required as contemplated in section 15(5) in a case where the existing and superseding municipalities do not account for VAT on the same accounting basis;
- the provisions of section 8(2) will not apply to the existing municipality upon its disestablishment and subsequent deregistration for VAT purposes unless any goods or rights capable of assignment, cession or surrender are not transferred to the superseding municipality as a result of the municipal boundary change, in which case, section 8(2) shall only apply to that extent;
- for the purposes of sections 16(2), 16(3), 17(1), 20 and 21, any valid tax invoice, debit or credit note or other prescribed document that has been issued in the name of the existing municipality, may be used as acceptable documentary proof for the purposes of deducting input tax or other

allowable deduction in the name of the superseding municipality for a period of six months after the effective date of the municipal boundary change, provided such deduction has not previously been allowed to the existing municipality;

- for the purposes of calculating the superseding municipality's apportionment percentage as prescribed by section 17(1) and the related annual adjustment, symbols (a), (b) and (c) in the Formula in BGR 4 (Issue 3) shall be the aggregate of the values of those symbols for the existing and superseding municipalities for the financial year concerned; and
- as a superseding municipality becomes the successor in law of the existing municipality in the event of a complete merger, the superseding municipality is liable to account to SARS for any VAT liability or outstanding VAT returns in relation to the activities of the existing municipality that arose before the effective date of the municipal boundary change.

8.2. BGR 48 – The temporary letting of dwellings by developers and the expiry of section 18B

This BGR provides clarity on the VAT treatment of residential fixed properties consisting of dwellings (the dwellings) which were developed for the purpose of sale, but were subsequently temporarily let by the residential fixed property developers (the developers). Clarity is also provided in respect of the cessation of section 18(B). This BGR applies to all dwellings that were let temporarily by the developer for the first time during the period falling on or after 10 January 2012 until 31 December 2017 (the relief period).

Background

Under section 18(1), a vendor that changes the use or application of goods or services from a wholly or partly taxable purpose to a wholly non-taxable purpose is deemed to have made a taxable supply in the course or furtherance of the vendor's enterprise. The time of supply under section 9(6) is deemed to be the time that the

change in application occurs. The consideration for the supply under section 10(7) is deemed to be equal to the open market value of the goods or services. The effect of this is that the vendor is required to make an output tax adjustment calculated by applying the tax fraction of the open market value when the change in application occurs. In this regard, the developers that applied their residential property stock for letting as a result of adverse economic factors became liable to make an output tax adjustment under section 18(1).

Application of the law

Section 18B – Temporary relief

Section 18B came into operation on 10 January 2012 to provide temporary relief to the developers that:

- developed new dwellings for the purpose of sale; and
- subsequently applied such dwellings for exempt supplies under section 12(*c*)(i) (supplying accommodation in a dwelling under an agreement for the letting and hiring thereof).

At commencement, the application of section 18B was to cease on 1 January 2015 but was, with effect from 10 January 2012, extended for an additional period of three years and ceased to apply on 1 January 2018. The effect of this is that the application of section 18B was extended to apply to the change in use of the dwellings which occurred for the first time during the period falling on or after 1 January 2015 until 31 December 2017.

Section 18B(2) – Suspends the application of section 18(1) during the relief period

Under section 18B(2), the developer is deemed not to have made a taxable supply, when the property is applied under an agreement for letting as contemplated in section 12(*c*)(i). The effect of section 18B(2) is that the output tax adjustment that would otherwise have arisen under section 18(1) is suspended during the relief period. As a result, during the relief period, the developer is not required to make an output tax adjustment at the time that the actual change in application occurs.

Section 18B(3) – Value of the supply and new time of supply

Section 18B(3) deems the developer to have supplied the dwelling concerned by way of a taxable supply for a consideration equal to the open market value thereof as contemplated in section 10(7) at the earlier of:

- the expiry of the 36-month period after concluding the letting agreement which resulted in the change in application (the 36-month period); or
- the date on which the developer permanently applies the property for a non-taxable purpose.

The 36-month period applies per property, from the date it is first let out, and not per rental agreement. It is also a maximum period during which the particular dwelling may be subject to a temporary letting arrangement without invoking the adjustment contemplated in section 18B(3). The effect of this is that the developer is required to make an output tax adjustment calculated by applying the tax fraction of the open market value of the property at the time that the supply is deemed to be made, being the earlier of the end of the prescribed period of 36 months or the time that the dwelling is applied permanently for non-taxable purposes.

Ruling

A developer, that developed dwellings for sale but subsequently applied one or more of such dwellings for temporarily letting during the relief period, must account for the output tax adjustment based on the open market value of each dwelling concerned in the tax period during which the 36-month period ends. The 36-month period is calculated from the date that any agreement for the temporary letting of the dwelling concerned was entered into for the first time from 10 January 2012 until 31 December 2017. Where the 36-month period expires after 31 December 2017 and the property was not permanently applied for non-taxable purposes, the developer must account for the output tax in the tax period falling on the date when the 36-month period expires. For example, a developer that applied a dwelling for temporarily letting for the first time on 31 December 2017, must account for the output tax adjustment in the tax period within which 31 December 2020 falls.

Should any of the such dwellings be applied permanently for non-taxable purposes during the relief period, the developer is required to account for the output tax

adjustment in the tax period in which the specific dwelling is applied permanently for non-taxable purposes.

As section 18B expired on 31 December 2017, any such dwelling that is temporarily let from 1 January 2018 no longer qualifies for the relief previously provided under that provision.

9. BINDING CLASS RULINGS

9.1. BCR 64 – Transfer of a security that constitutes a participatory interest in a collective investment scheme

This ruling determines security transfer tax consequences of the transfer of a security that constitutes a participatory interest in a collective investment scheme, regulated by the Collective Investment Schemes Control Act 45 of 2002 (CISCA).

In this ruling references to sections are to sections of the STT Act applicable as at 14 September 2017. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the STT Act.

This is a ruling on the interpretation and application of:

- section 1 – definition of 'security'
- section 2(1)(*a*); and
- section 8(1)(*f*).

<u>Class</u>

The class members to whom this ruling will apply are the holders of the Class B Shares.

<u>Parties to the proposed transaction</u>

The applicant: A resident company

The class members: The holders of class B shares

Company X: A non-resident company

The fund: A fund of Company X, which has been duly approved as a foreign collective investment scheme (CIS)

The nominee: A non-resident company

Description of the proposed transaction

The applicant is the South African investment manager of a fund of Company X. Company X is an open-ended umbrella type investment company with segregated liability between its funds. It is authorised as an undertaking for collective investment in transferable securities. The Fund has been duly approved as a foreign CIS in terms of section 65 of CISCA. The fund proposes to list the classB shares on the JSE.

The objective of the fund is to replicate the performance of global equity markets. Investments may be marketed to members of the public in South Africa.

The class B shares will be linked to the fund and the economic performance of those shares will be determined by the economic performance of the investment portfolio held by the fund.

The class B shares will be issued to a nominee company as the registered shareholder which will keep a register of the South African Investors (the class members).

The class members will acquire beneficial ownership in the shares and will from time to time dispose of their interests to realise their investments.

Conditions and assumptions

This binding class ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The transfer of the class B shares from and to the class members will not attract STT under section 8(1)(*f*) of the STT Act.

9.2. *BCR 65 – Post-retirement medical aid benefits*

This binding class ruling is published by consent of the applicant(s) to which it has been issued. It is binding as between SARS and the applicant(s), and the class members only and published for general information. It does not constitute a practice generally prevailing.

This ruling determines the tax consequence of the intra-fund allocation of an amount from an employer surplus account to a member's fund credit.

In this ruling references to paragraphs are to paragraphs of the Fourth Schedule and Seventh Schedule to the Act applicable as at 10 May 2018. Unless the context indicates otherwise any word or expression in this ruling bears themeaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- paragraph 1 – definitions of "remuneration" and "employer" of the Fourth Schedule;
- paragraph 1 – definition of "associated institution",
- paragraph 2(*l*),
- paragraph 4, and
- paragraph 12D of the Seventh Schedule.

Class

The class members to whom this ruling will apply are the provident fund members.

Parties to the proposed transaction

The applicant: A company incorporated in and a resident of South Africa

The class members: The affected members of a provident fund, who are employees of the applicant

Description of the proposed transaction

The class members, who are members of a defined contribution provident fund, are entitled to a post-retirement medical aid lump sum benefit on retirement

(including ill-health retirement) or death. The trustees of the fund wish to negotiate a voluntary transfer of the benefit. The transfer will entail allocating an amount from the employer surplus account to the fund credit of each affected member, *in lieu* of the benefit that would have been payable as at retirement (or death). Therefore, in return for a certain amount allocated to each member's fund credit, the affected member will give up his or her right to claim the benefit from the applicant.

Conditions and assumptions

This binding class ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The intra-fund allocation of an amount from the employer surplus account to a member's fund credit will trigger a taxable fringe benefit for the class members.

10. INDEMNITY

Whilst every reasonable care has gone into the preparation and production of this update, no responsibility for the consequences of any inaccuracies contained herein or for any action undertaken or refrained from taken as a consequence of this update will be accepted.